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IN THE

Supreme Court of the United States

OCTOBER TERM 1978

NO. 78-920

GENERAL CRUDE OIL COMPANY,
Petitioner

v.

DEPARTMENT OF ENERGY and
UNITED STATES OF AMERICA,
Respondents

PETITION FOR A WRIT OF CERTIORARI TO THE TEMPORARY EMERGENCY COURT OF APPEALS

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TABLE OF CONTENTS

	Page
OPINIONS BELOW	1
JURISDICTION	2
QUESTIONS PRESENTED	2
PERTINENT CONSTITUTIONAL PROVISION, STATUTES AND REGULATIONS	3
STATEMENT OF THE CASE	
1. Introduction	5
2. Background Facts	6
3. Armour's Right to Sell Product 15 as Residual Fuel	9
4. Pertinent Parts of Administrative Proceeding	9
5. Pertinent Court Proceedings	11
6. Consequences of Enforcing the Remedial Order	11
REASONS FOR THE WRIT	
1. Agency Action Should Not Be Upheld on the Basis of *Post Hoc* Rationalization	14
2. The TECA Decision Conflicts with Well-Settled Principles that Agency Action May Not be Sustained When It is Inconsistent with Agency Regulations and Decisions and its Governing Statutes	21
3. This Court Should Decide the Important Federal Question Whether General Crude was Entitled To a Formal Hearing	
and	
4. Whether a Formal Hearing was Required Calls Into Question the Validity of the Agency's Governing Statute	26
CONCLUSION	30
APPENDIX	
Opinion by the Temporary Emergency Court of Appeals	A-1
Opinion by the District Court	A-20
Supplemental Memorandum by the District Court	A-25

	Page
Appeal Decision by the Federal Energy Administration	A-26
Remedial Order Decision by the Federal Energy Administration	A-51
Denial of Rehearing or Rehearing En Banc by the Temporary Emergency Court of Appeals	A-72
Text of Pertinent Statutes	A-73

TABLE OF AUTHORITIES

CASES

Atchison, T. & S.F. Ry. Co. v. Wichita Board of Trade, 412 U.S. 800 (1973)	21
Burlington Truck Lines, Inc. v. United States, 371 U.S. 156 (1962)	19, 20
Bayside Enterprises, Inc. v. N.L.R.B., ____U.S.____, 97 S.Ct. 576 (1977)	21
Blackwell College of Business v. Attorney General, 454 F.2d 928 (D.C. Cir. 1971)	29
Codd v. Velger, ____U.S.____, 97 S.Ct. 882 (1977)	29
Contractors Transport Corp. v. United States, 537 F.2d 1160 (4th Cir. 1976)	22
Ehlert v. United States, 402 U.S. 99 (1971)	21
Frozen Food Express, Inc. v. United States, 535 F.2d 877 (5th Cir. 1975)	22
F.T.C. v. Sperry and Hutchinson Company, 405 U.S. 233 (1972)	19
Greyhound Corp. v. ICC, 551 F.2d 414 (D.C. Cir. 1977)..	21
Independent Bankers Association of Georgia v. Board of Governors of F.R.S., 516 F.2d 1206 (D.C. Cir. 1975) ..	29
Matthews v. Eldridge, 424 U.S. 319 (1976)	29, 30
Morton v. Ruiz, ____U.S.____, 94 S.Ct. 1055 (1976) ...	23
Office of Communication of the Church of Christ v. FCC, 560 F.2d 529 (2d Cir. 1977)	22
Securities and Exchange Commission v. Chenery Corp., 332 U.S. 194 (1947)	14
Udall v. Tallman, 380 U.S. 1 (1965)	22
University of Southern California v. Cost of Living Council, 472 F.2d 1065 (T.E.C.A. 1972), *cert. denied,* 410 U.S. 928 (1973)	21
Wong Yang Sung v. McGrath, 339 U.S. 33 (1950)	27, 28

STATUTES AND REGULATIONS

	Page
U.S. CONSTITUTION, amend. V	3
Administrative Procedure Act, 5 U.S.C. §§551 *et seq.* (1977)	
§ 552	3
§ 553	3
§ 554(a)	27
§ 555(e)	3
28 U.S.C. § 1254(1)	2
Department of Energy Organization Act, 42 U.S.C. §§ 7101 *et seq.* (1977 Supp.)	
§ 301(a)	4
§ 502(a)	4
§ 503	28
Economic Stabilization Act of 1970, 12 U.S.C. § 1904 note	
§ 207(a)	3
§ 211(d)(1)	3
§ 211(g)	2
Emergency Petroleum Allocation Act of 1973, 15 U.S.C. §§ 751 *et seq.* (1975 Supp.)	
§ 4(b)	4
§ 4(b)(1)(D)	13
§ 4(b)(1)(I)	13
§ 4(b)(1)(F)	14, 20
§ 5(a)(1)	3, 28
§ 5(a)(1)(A)	2
Energy Policy and Conservation Act, 89 Stat. 950 (1975)	
§ 455	4, 5, 24
§ 551	5
Executive Order No. 12009, 42 Fed. Reg. 46267 (September 15, 1977)	5
10 C.F.R. § 210.35	12, 25
§ 210.35(a)	5
§ 212.31	4, 6, 10, 16
Part 212, Subpart D	6
Part 212, Subpart E	6

Page

DOE ADMIN. DECISIONS

G. E. Kadane & Sons, 3 FEA ¶ 80,516 (December 5, 1976) 22, 23
General Crude Oil Company, 4 FEA ¶ 83,104 (September 21, 1976) 7, 12
General Crude Oil Company, 5 FEA ¶ 80,582 (March 25, 1977) 12
Husky Oil Co. v. DOE, 3 CCH Energy Management Reporter ¶ 26,110 (August 10, 1978) 22, 24
McCulloch Gas Processing Corp., 1 FEA ¶ 20,180 (Nov. 5, 1974) 23
Ryder System, Inc., 1 FEA ¶ 20,742 (Dec. 16, 1974) 23
The Independent Oil Compounders Ass'n, Interpretation No. 78-33 (July 10, 1978), CCH Enforcement Manual ¶ 56,424 23
Tristate Oil and Asphalt Sales, Inc., Interpretation No. 78-22 (June 9, 1978), CCH Enforcement Manual ¶ 56,413 . 23

MISCELLANEOUS

39 Fed. Reg. 16,288 (May 14, 1974) 13
Conference Report No. 93-628; 93d Cong., 1st Sess., reprinted in [1973-2] U.S. Code Cong. & Admin. News 2688 *et seq.* 13
Conference Report No. 95-539, 95th Cong., 1st Sess, reprinted in [1977-2] U.S. Code Cong. & Admin. News 956 28
Elkins, The Temporary Emergency Court of Appeals: A Study in the Abdication of Judicial Responsibility, 1978 Duke L.J. 113 22
Friendly, "Some Kind of Hearing," 123 U. Pa. L. Rev. 1267 (1975) 27

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OPINIONS BELOW

The opinion of the Temporary Emergency Court of Appeals is reproduced in the Appendix at pages A-1 through A-19. The memorandum opinion and order of the United States District Court for the Southern District of Texas is unofficially reported at CCH Energy Management Transfer Binder—Court Decisions ¶ 26,102 and is reproduced in the Appendix at pages A-20 through A-24. The District Court's Supplemental Memorandum, dated May 12, 1978, is reproduced in the Appendix at

page A-25. The appeal decision of the Federal Energy Administration, dated October 22, 1976, from which petitioner sought judicial review, reported unofficially at 4 FEA ¶ 80,552, is reproduced in the Appendix at pages A-26 through A-50. The agency Remedial Order rendered in this proceeding, dated May 21, 1976, is reproduced in the Appendix at pages A-51 through A-76.

JURISDICTION

This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1), § 211(g) of the Economic Stabilization Act, 12 U.S.C. § 1904 note, and § 5(a)(1)(A) of the Emergency Petroleum Allocation Act, 15 U.S.C. § 754(a)(1)(A). The Temporary Emergency Court of Appeals rendered its decision on October 12, 1978, and denied petitioner's timely request for rehearing and suggestion for rehearing *en banc* on November 9, 1978. App. A-72. The Court of Appeals and District Court had jurisdiction pursuant to § 211 of the Economic Stabilization Act and § 5(a)(1)(A) of the Emergency Petroleum Allocation Act.

QUESTIONS PRESENTED

(1) Whether TECA erred in employing in its opinions and in permitting counsel for the Federal Energy Administration to rely on, legal theories and facts, not contained in agency decisions against General Crude Oil Company ("General Crude"), as *post hoc* rationalizations of the agency action, contrary to principles enunciated by this Court?

(2) Whether TECA erred in affirming the Federal Energy Administration's analysis of its price control

regulations bearing on General Crude's case, in light of the facts that (a) the agency determination was plainly inconsistent with (i) the literal terms of the regulations, (ii) prior administrative actions, (iii) the goals of the national energy policy, and (iv) the statutory and regulatory provisions permitting de-control of residual fuel oil; and (b) the "great deference" standard of judicial review was inappropriate to this proceeding?

(3) Whether General Crude was deprived of statutory and constitutional due process of law by a plethora of procedural infirmities, including the denial by the agency of General Crude's request for an evidentiary hearing in which to present evidence concerning disputed material facts?

PERTINENT CONSTITUTIONAL PROVISION, STATUTES AND REGULATIONS

The Fifth Amendment to the United States Constitution provides, in pertinent part:

> No person . . . shall . . . be deprived of life, liberty, or property, without due process of law. . . .

Economic Stabilization Act of 1970, 12 U.S.C. § 1904 note, § 207(a), provides:

> The functions exercised under this title are excluded from the operation of subchapter II of chapter 5, and chapter 7 of title 5, United States Code, except as to the requirements of sections 552, 553, and 555(e) of title 5, United States Code.

Economic Stabilization Act of 1970, 12 U.S.C. § 1904 note, § 211(d)(1) was incorporated by the Emergency Petroleum Allocation Act, § 5(a)(1), 15 U.S.C. § 754

(a)(1) (1975 Supp.) and incorporated by §§ 301(a) and 502(a), Department of Energy Organization Act, 42 U.S.C. §§ 7101 *et seq.* (1977 Supp.), and provides in pertinent part as follows:

> . . . no order of such agency shall be enjoined or set aside, in whole or in part unless a final judgment determines that such order is in excess of the agency's authority, or is based upon findings which are not supported by substantial evidence.

Emergency Petroleum Allocation Act of 1973, as amended, § 4(b), 15 U.S.C. §§ 751, *et seq.* (1975 Supp.). See Appendix for text.

Energy Policy and Conservation Act § 455, 89 Stat. 950, 965 (1975). See Appendix for text.

The definitional section of the Federal Energy Administration price control regulations in 10 C.F.R. § 212.31, provided in pertinent part throughout the period covered by this action:

> "Producer" means a firm or that part of such a firm which produces *crude oil* or natural gas or any firm which owns *crude oil* when it is produced. 39 Fed. Reg. 44407 (December 24, 1974). (Emphasis added.)
>
> "Crude Oil" means a mixture of hydrocarbons that existed in liquid phase in underground reservoirs and remains liquid at atmospheric pressure after passing through surface separating facilities. . . .
>
> [Prior to the promulgation of this definition of "crude oil," 40 Fed. Reg. 2975 (January 16, 1975) the term was simply defined as "crude petroleum", 39 Fed. Reg. 12353 (April 5, 1974).]

> "Refiner" means a firm or that part of such a firm which *refines* covered products or *blends and substantially changes* covered products. . . . 39 Fed. Reg. 1924 (January 15, 1974). (Emphasis added.)
>
> "Covered products" means crude oil, residual fuel oil and refined petroleum products. 39 Fed. Reg. 12353 (April 5, 1974).
>
> "Residual Fuel Oil" means those fuel oils commonly known as ASTM Grades No. 5 and No. 6 fuel oils, heavy diesel, Navy Special, Bunker C and all other fuel oils which have a fifty percent boiling point over 700°F. in the ASTM D86 standard distillation test. 40 Fed. Reg. 2795 (January 16, 1975).

Effective June 1, 1976, residual fuel oil as a product was exempted from both the mandatory price control and petroleum product allocation regulations by 10 C.F.R. § 210.35(a), promulgated pursuant to §§ 455 and 551 of the Energy Policy and Conservation Act, *supra*:

> Residual fuel oil is exempt from the provisions of Part 211 [allocation regulations] and Part 212 [price regulations] of this chapter. 41 Fed. Reg. 13897 (April 1, 1976).

STATEMENT OF THE CASE

1. *Introduction.* This petition seeks review of a decision of TECA upholding a remedial order action by FEA[1] against General Crude that would require the com-

1. "FEA" will refer herein to the Federal Energy Administration, which supervised the administration of petroleum price and allocation statutes until October 1, 1977. On that date, the Department of Energy assumed FEA's functions pursuant to 42 U.S.C. § 7151(a); Executive Order No. 12009, 42 Fed. Reg. 46267 (September 15, 1977). References to FEA include, where applicable, the DOE and FEA's predecessor agencies.

pany to refund approximately $5 million to its customers for alleged overcharges in sales of a product called "Product 15." TECA's decision overruled a contrary opinion and ruling of the District Court for the Southern District of Texas.

There is no dispute between the parties that the residual fuel oil product made by General Crude (Product 15) satisfies FEA's definition of residual fuel oil. But because of the unique method of Product 15's manufacture, which occurs at the Banning Lease rather than in a typical refinery facility, the regulatory issue is (i) whether General Crude is a "refiner", and Product 15 is "residual fuel oil"; or (ii) whether General Crude is a "producer" and Product 15 is "crude oil". 10 C.F.R. § 212.31. If found to be a "producer" of "crude oil" as FEA and TECA have concluded, General Crude must sell Product 15 under the crude oil price rules contained in 10 C.F.R. Part 212, Subpart D. As a "refiner", General Crude would be entitled to sell Product 15 at the higher prices appropriate for residual fuel oil under 10 C.F.R. Part 212, Subpart E. Analysis of the regulatory definitions in light of the facts of General Crude's operation are therefore crucial to an understanding of the issues.

2. *Background Facts.* Since 1966, General Crude has been the operator and half-owner of the working interest in the Banning Lease, located in Orange County, California. The other half-owner of the working interest is G.E. Kadane & Sons. Recovery proceeds on the lease by means of *in situ* combustion, an exotic enhanced recovery technique that involves the ignition and controlled burning under controlled pressure of part of the heavy crude oil in the reservoir (R. 388-93). Begun in 1958, the *in situ* combustion operation at the Banning

Lease is one of just two such long-lived experiments of its kind in the world (R. 920, 935). Remarkably, this extremely high-temperature process "cracks" the hydrocarbons in the reservoir into lighter fractions and effects substantial chemical and physical changes indicative of refining, as has been confirmed by two laboratory analyses (R. 273).[2] *In situ* combustion is extremely expensive to maintain. See *General Crude Oil Company* Exception Decision, 4 FEA ¶ 83,104 (September 21, 1976) (R. 900).

Until December 1, 1973, General Crude sold its share of production from the lease to Standard Oil Company of California ("SOCAL"), a major integrated oil company, under a contract that placed no restriction on SOCAL's use of the product. On May 1, 1973, General Crude provided SOCAL with a required six-month notice of the contract's cancellation, because the Banning Lease

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2. Tests on the product commissioned by General Crude in 1973 confirmed the evidence of laboratory tests by SOCAL in 1960, and showed the following changes induced because of the high-temperature burn (R. 391):

1. The gravity of the product is changed from 15.4° API to 17.4° API.
2. The change in the distillation curve shows that the "refined" oil has been enriched in light boiling components, primarily in the gasoline boiling range. The "refined" product contains approximately twice the amount of gasoline in the original crude oil in the ground.
3. Oxidation and other modifications of the light distillate cut produced as a result of the "refining" processes were significant, indicating that the incremental distillates were ***highly cracked.***
4. The 150-350° F. boiling range naphtha from the "refined" oil shows a considerably higher total nitrogen, basic nitrogen, chloride, sulphur, phenol and unsaturates contents (bromide number) compared to the original crude oil in the ground.
5. The color and the cracked odor are very pronounced in the "refined" product.

was losing money at the price SOCAL paid for its output. This notice predated the advent of petroleum industry price controls by several months.

At this time, market conditions, chiefly a rise in the historically low price of residual fuel oil in the California market (R. 390-92), spurred General Crude to consider how it might capitalize on the "cracked" state of the Banning Lease production. Further tests conducted by General Crude in 1973 determined that the "cracked" product could undergo additional blending and treating at the lease surface and that the final product would satisfy the specifications of residual fuel oil (R. 391). Following negotiations with several parties, General Crude finally contracted to sell Product 15, a residual fuel oil, to Armour Oil Company, an independent marketer who resells to other purchasers, at an indexed price higher than had been received from SOCAL.

Product 15 was *not* simply the Banning Lease production that SOCAL had previously purchased. Rather, it was a new compound which satisfied residual fuel oil specifications and was created by blending and treating cracked and non-cracked reservoir fluids (R. 390-91). Manufacture of Product 15 was made possible only through installation by General Crude of above-ground blending and treating facilities at the Banning Lease in November, 1973, in contemplation of its contract with Armour.

Since December, 1973, General Crude has sold its share of Product 15 solely for use as residual fuel oil.[3]

3. General Crude's selection of the then-newly promulgated "refiner" price rules for sales of Product 15 was aided by an opinion of the Petroleum Regulation Expert (Mr. Gary Dossett) of the Internal Revenue Service, FEA's predecessor, reflected in an Appendix to the TECA opinion.

General Crude's only customer of Product 15 has been Armour Oil Company. Armour has sold Product 15 to such customers as the United States Navy, Air Force, Marine Corps, several VA hospitals and various industrial customers, which have used it as fuel oil (Amended R. 829C). Newhall Refining Company attested that Product 15 had no economic merit as refinery feedstock in Newhall's refinery, but was vital to the company's marine bunker fuel supply; Newhall independently verified Product 15's chemical identity as Bunker "C" fuel oil (Amended R. 829J).

3. *Armour's Right to Sell Product 15 as Residual Fuel Oil.* Armour's sale of Product 15 as residual fuel oil and at residual fuel oil prices was officially approved by IRS (FEA's predecessor in enforcing petroleum price controls) on June 27, 1974 (R. 203-04). FEA acknowledged in oral argument before the District Court and TECA that in Armour's hands Product 15 is residual fuel oil and may be sold as such.

4. *Pertinent Parts of Administrative Proceeding.* On October 17, 1975, FEA issued to General Crude a "Notice of Probable Violation" (R. 252) alleging that General Crude had improperly sold Product 15 "crude oil" from the Banning Lease to Armour at the regulatory prices applicable to refined products rather than at crude oil prices. This Notice officially became a refund order with the agency's issuance of a Remedial Order on May 21, 1976.

Appealing the Remedial Order to FEA's Office of Exceptions and Appeals, General Crude submitted to FEA the above-stated facts and tendered, *inter alia*, the following additional facts:

1. In its natural state in the reservoir the crude oil from the Banning Lease is not residual fuel oil as defined in 10 C.F.R. § 212.31 and is not suitable for use as residual fuel oil;

2. As a result of the "cracking" of the natural crude oil (by *in situ* combustion) and the blending and treating operations, the product which General Crude sells to Armour is materially and substantially different from crude oil in its natural state in the reservoir.

3. The product which General Crude sells to Armour is residual fuel oil and meets the definition of that term as set forth in 10 C.F.R. §212.31.

(R. 297-98). General Crude observed that its previous submission confirmed these facts,[4] but requested a hearing before FEA pursuant to FEA's procedural regulations (10 C.F.R. Part 205) if the agency disputed any of these facts (R. 398). *No such hearing was ever conducted.* General Crude felt that the noted facts were necessary to prove its consistent contention throughout these proceedings, that General Crude's Banning Lease activity satisfied the literal terms of FEA's "refiner" definition as one that "refines covered products" and "blends and substantially changes covered products." 10 C.F.R. § 212.31.

FEA's Appeal Decision and Order affirmed the essence of the Remedial Order, but neither agency opinion fairly treats the application of the "refiner" definition to General Crude. *Infra* on "Reasons for the Writ."

4. The previous submission included the laboratory analyses quoted at note 2, *supra*, which reflect in technical terms the indicia of chemical change occasioned by *in situ* combustion.

5. *Pertinent Court Proceedings.* The District Court rescinded the Remedial Order on the bases that (i) there was not substantial evidence to support FEA's conclusion that General Crude was a "producer" of "crude oil" and not a "refiner" of "residual fuel oil," and (ii) enforcement of the Remedial Order would be inimical to Congressional energy policy objectives.

The court's review of evidence relative to the company's Banning Lease activity recites most of the previously referenced facts, including several as to which FEA declined to hold a hearing. The court could base its decision on these underlying facts (i) because they appeared uncontested in the agency "record," and (ii) because FEA's counsel had stipulated specifically that the factual submissions quoted in the previous section of this Petition (as well as all other submissions by General Crude during the agency proceeding) would be accepted as fact for purposes of judicial review. See Affidavit of James V. Carroll, III, June 7, 1978. General Crude's attorney read these stipulations into the record at oral argument before the District Court referring to them as "stipulations" based on an "understanding I have with Ms. Pence," (R. 1049-51). (Ms. Pence was lead counsel for FEA). Of course, since the stipulations were entered by agreement, FEA's attorneys made no objections.

As will be seen below, the agency, in a stunning and reprehensible change of position, contested some of these material and stipulated facts for the first time before TECA. The appellate court, succumbing to the agency invitation to *post hoc* rationalization, reversed the District Court and affirmed the Remedial Order.

6. *Consequences of Enforcing the Remedial Order.* If TECA's decision is upheld and the Remedial Order en-

forced against General Crude, the company will have to refund $5 million to Armour. Also, FEA has counterclaimed in this suit to recover a $20,000 daily penalty from General Crude for violating FEA price regulations (R. 162). FEA's Motion for Summary Judgment reserved the issue of recovery of the penalty until its efforts herein to establish the violation have been completed (R. 747). In addition, the company will have to cease *in situ* combustion at the Banning Lease, because "old oil" prices will not begin to compensate for the costs of that operation.[5] Without *in situ* combustion and the "cracking" process it entails, not only will manufacture of Product 15 halt, but production from the Banning Lease will be sharply reduced. An estimated 6.5 million barrels of crude oil will be lost (R. 1094).

Two egregious anomalies arise from enforcing the Remedial Order. First, even though General Crude will refund $5 million to Armour, that company's price for Product 15, commensurate with other residual fuel oils, has been officially sanctioned by the agency. As noted above, FEA has admitted that Armour will not be required to pass the refunds through to subsequent customers. Second, as of June 1, 1976, residual fuel oil as a product was de-controlled by FEA, on congressional approval of findings that no further need for price or allocation regulation remained. 10 C.F.R. § 210.35; 41

5. As FEA will undoubtedly mention, General Crude applied to FEA for "exception relief," seeking permission to sell Product 15 at un-controlled prices (assuming crude oil prices were ultimately imposed on its activity) in order to keep the *in situ* combustion project alive. Neither in its decision awarding partial relief nor in its appeal decision, *General Crude Oil Company*, 4 FEA ¶ 83,104 (September 21, 1976) and 5 FEA ¶ 80,582 (March 25, 1977), however, did FEA allow sufficient price incentive over the "old oil" price to justify necessary costs of the project.

Fed. Reg. 13897 (April 1, 1976). Effective on that date, General Crude will be the only seller of residual fuel oil in the country subject to price controls, and at crude oil price levels! And, of course, Armour has since June 1, 1976, been free to sell Product 15 as residual fuel oil, at exempt prices.

Moreover, in light of these consequences, no goal of national energy policy will be furthered by the Remedial Order and several are directly contravened. The loss of 6.5 million barrels of crude oil recoverable only by *in situ* combustion undermines Congress' injunction that petroleum regulations "not be implemented in a manner which would have the net effect of occasioning a substantial reduction in the total supply of crude [and] residual fuel oil . . ." 1973-2 U.S. Code Cong. & Admin. News 2691. Second, Armour, an independent marketer, will be deprived of its primary supply of residual fuel oil when manufacture of Product 15 ends, a result contrary to congressional solicitude for the economic viability of independent marketers. Emergency Petroleum Allocation Act of 1973, § 4(b)(1)(D), 15 U.S.C. §§ 751, *et seq.* (1975 Supp.) (hereafter "EPAA"). Third, un-cracked Banning crude will now have to be processed in a refinery, needlessly occupying refinery capacity, which Congress and FEA recognize is in short supply. 1973-2 U.S. Code Cong. & Admin. News 2705; 39 Fed. Reg. 16288 (May 14, 1974). Fourth, although § 4(b)(1)(I) of the EPAA seeks to minimize ecenomic distortion, inflexibility and unnecessary interference with market mechanisms, that goal is repudiated by all of the effects just listed.

Confronted by General Crude with these consequences that the Remedial Order would inflict (R. 424-30) and with the ultimate conclusion that the order can only be

justified as price control for price control's sake, the FEA said—nothing. Not until court proceedings were underway did the agency begin to rationalize its actions in terms of the goal of controlling petroleum prices (see EPAA § 4(b)(1)(F)), a view rendered ridiculous by FEA's admission that Armour is free to sell Product 15 as resdual fuel oil at exempt prices. Thus, rather than controlling prices for the benefit of the national economy, the purpose for which Congress authorized price controls, FEA would create an *enormous economic windfall for Armour!*

The District Court rejected FEA's transparently false rationalization, while TECA accepted it in dangerous submissiveness to agency "discretion."

The implications of the foregoing discussion raise issues basic to administrative law that should be passed on by this Court.

REASONS FOR THE WRIT

1. Agency Action Should Not Be Upheld On The Basis of Post Hoc Rationalizations.

Few rules are more firmly ensconced in administrative law than that which requires the reviewing court to "judge the propriety of such [agency] action solely by the grounds invoked by the agency." *Securities and Exchange Commission v. Chenery Corp.*, 332 U.S. 194, 196 (1947). TECA's decision herein squarely conflicts with this rule in two significant aspects.

(a) *Application of "Substantial Change" Test.*

The "refiner" definition, *supra* at 5, describes disjunctively activities qualifying for refiner status, including: a firm that "refines covered products" or "blends and substantially changes covered products." As evidenced by the discussion that follows, the sole regulatory issue regarding whether General Crude qualifies for refiner status, is whether the cracking, blending and treating processes effect "substantial change."

(i) *General Crude's Argument.* Throughout the agency and court proceedings below, General Crude has maintained that the cracking, blending and treating processes employed at the Banning Lease convert unusable natural-state crude oil into genuine specification residual fuel oil, and that this chemical change constitutes "substantial change" for purposes of the refiner definition. As a result, General Crude's activities at the Banning Lease are those of a "refiner" of "residual fuel oil."

(ii) *FEA's Orders.* Despite General Crude's arguments and admonitions to the agency, FEA refused in its orders to apply the "substantial change" test, disingenuously choosing instead to divide the total process, for analytical purposes, into a below-ground phase and an above-ground phase. About the *below-ground* cracking process, FEA said,

> Although the chemical composition of the substance recovered is in fact altered somewhat . . . the incidental alteration in the chemical composition which occurs does not mean that General Crude 'refines' covered products . . . App. A-35.

About the *above-ground* processes, FEA said,

> . . . these operations are rather rudimentary and certainly do not involve the complexity and sophisti-

> cation which are usually associated with the refining process. Furthermore, they do not substantially alter the nature of the product *after its emergence from the ground.* App. A-35. (Emphasis supplied.)

Thus, FEA avoided the "substantial change" test by characterizing those admitted chemical changes occurring below-ground as "incidental" to the primary purpose of extraction, and applying the "substantial change" test only to the above-ground blending and treating processes, finding them to be insubstantial.

(iii) *District's Court Decision.* General Crude pointed out this error to the District Court, arguing that the "substantial change" test must be applied to the entire process that creates Product 15, including both the above-ground and the below-ground phases. The District Court accepted General Crude's argument:

> General Crude substantially changes the nature of the Banning product by 'cracking' the hydrocarbons into lighter fractions, and thereafter dehydrating and blending the 'cracked' product with the original crude oil above the ground to produce Product 15, which activities put General Crude within the 'refiner" definition in 10 C.F.R. § 212.31 as one who 'blends and substantially changes covered products.' App. A-22.

(iv) *FEA Argument to TECA.* Finally recognizing the vulnerability of the Remedial Order's failure to apply the "substantial change" test, FEA advanced several new arguments to TECA that were never before suggested in justification of the Remedial Order:

First, FEA retracted the stipulations entered into during oral argument before the District Court, including

the stipulation that the Banning Lease processes produce a refined product that is "substantially and materially different" from the natural-state crude oil. (see discussion *supra* at 9-11.)

Second, for the first time, FEA confronted General Crude's position that its below-ground cracking process "substantially changed" the crude oil from its natural state.

Third, FEA argued that the cracking process and resulting chemical change in API gravity from 15.4° to 17.4° proved that the chemical change was not "substantial change."

FEA's final two briefs to TECA raised these new matters. In its Responsive Brief to General Crude Oil Company, FEA said:

> Indeed, plaintiff has admitted that after the *in situ* process, the gravity of the crude oil is *merely* changed from 15.4° API in the underground reservoir to 17.4° API. Such a change in the API gravity clearly demonstrates that plaintiff's processes did not substantially and materially alter the product, thereby entitling it to a refiner classification.

And in the Response of the Government to the July 14, 1978 Letter of General Crude, FEA said:

> General Crude's *in situ* enhanced recovery technique does not substantially alter crude oil under the ground. Indeed, General Crude itself admitted that fact when it stated that after the *in situ* process, the gravity of the crude oil is modified only from 15.4° API in the underground reservoir to 17.4° API.

Of course, neither of FEA's orders referred to the API gravity change or stated that the degree of such change was significant to the "substantial change" test.

(v) *TECA's Decision.* TECA adopted these eleventh-hour arguments of FEA when, in its decision, it held,

> The chemical change was insubstantial. App. A-2.
>
> The record shows . . . that the only difference in the product resulting from the recovery processes used to extract and deliver the oil from the pre-*in situ* recovery technique was a change in the gravity of the crude oil from 15° to 17° API. Clearly, the FEA had a rational basis for application of the producer pricing rules to General Crude. . . . App. A-13.

(vi) *Materiality of the Post Hoc Arguments.* It can readily be seen that FEA's *post hoc* arguments to TECA quoted above and as adopted by TECA constitute the critical difference between General Crude's success and failure in this case. In the first of these arguments, FEA acknowledged (in the first sentence) that if the processes substantially and materially altered the product, General Crude is thereby entitled to refiner classification. The District Court's opinion in favor of General Crude was based upon a conclusion that the effect of the processes constituted "substantial change" within the meaning of the refiner definition. App. A-22.

Prompted by the FEA briefs,[6] TECA pulled an isolated fact from the administrative record (that *in situ* combustion raises the API gravity of crude oil under the

6. FEA flagrantly introduced many *post hoc* arguments and facts outside the "record" before TECA as integral parts of its appeal, and TECA just happened to select these among many.

Banning Lease from 15.4° to 17.4°) and found that this fact represents the "only difference" between the natural-state crude oil and Product 15. App. A-13. But the gravity change was not the only difference. The 1960 and 1973 laboratory analyses quoted in footnote 2, *supra*, reveal that there were several other indicia of chemical change. The Court was led to this error by FEA's *post hoc* arguments to TECA (page 17, *supra*), in which it quoted selectively from these analyses.

Neither the gravity-change fact, nor the "only difference" inference drawn from it, nor the ultimate conclusion that the "chemical change was insubstantial" are found in or relied upon by the agency orders. The agency should have, but inexplicably chose not to rest its decision upon whether General Crude's below-ground and above-ground processes satisfied the "substantial change" test, and TECA cannot fabricate a rationale for the agency on this critical issue. TECA's decision in this respect should be controlled and overturned by this Court's holding in *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 169 (1962), and *F.T.C. v. Sperry and Hutchinson Company*, 405 U.S. 233 (1972), wherein this Court prevented similar attempts by counsel to shift the agency's basis for decisions that could not stand as written.

(b) *Statutory Purposes.* The second of FEA's particularly damaging *post hoc* arguments to TECA involved General Crude's persistent attack on the Remedial Order for its outright irreconcilability with any of the statutory purposes entrusted to the agency. (See recital of these conflicts at 11-14, *supra.*) FEA, in its Remedial Order and Appeal Decision and Order, did not discuss General

Crude's arguments based on statutory policy. However, the District Court did assess such arguments and found that the agency orders were incompatible with statutory goals, and hence were arbitrary and exceeded the agency's authority. App. A-23-24.

Again seeking to patch up the glaring deficiencies in the agency's orders, FEA argued to TECA that the application of crude oil prices to Product 15 would coincide with the goal of controlling petroleum prices as set forth in § 4(b)(1)(F) of the EPAA. Again taking the bait, TECA relied on FEA's belated *post hoc* arguments.

Encouraged by counsel for FEA, TECA went beyond the agency's specific holdings to justify the Remedial Order in terms of FEA's authority under the EPAA. The agency had consistently failed, prior to General Crude's appeal to the courts, to address the question whether its action fulfilled any statutory goal. That question cannot be answered self-evidently in this case, as TECA implied. *Supra,* 11-14. This Court has stated that such *post hoc* rationalization "is incompatible with the orderly functioning of the process of judicial review." *Burlington Truck Lines, Inc. v. United States, supra.*

In conclusion, FEA's Remedial Order and Appeal Decision and Order never mentioned, and thus were not founded upon, a finding that the chemical change occasioned by *in situ* combustion did not constitute "substantial change." Likewise, the agency's orders did not evaluate the degree of change in API gravity from 15.4° to 17.4° as evidencing the quantum of chemical change and as constituting a barometer of its "substantiality."

Finally, the agency's orders did not discuss and were not founded upon the concept that the goal of controlling petroleum prices was one which was advanced by its action and which outweighed the negative consequences demonstrated by General Crude and credited by the District Court.

2. The TECA Decision Conflicts with Well-Settled Principles that Agency Action May Not Be Sustained when it is Inconsistent with Agency Regulations and Decisions and its Governing Statutes.

This Court and the balance of the circuit courts of appeals have uniformly held that an agency may not rule inconsistently in similar cases without giving reasons for the different outcomes. One circuit court has succinctly stated the rule: "This court emphatically requires that administrative agencies adhere to their own precedents or explain any departure from them." *Greyhound Corp. v. ICC,* 551 F.2d 414, 416 (D.C. Cir. 1977). See *Bayside Enterprises, Inc. v. N.L.R.B.,* ____U.S.____, 97 S.Ct. 576, 580 (1977); *Atchison, T. & S.F. Ry. Co. v. Wichita Board of Trade,* 412 U.S. 800 (1973); *Ehlert v. United States,* 402 U.S. 99, 105 (1971). TECA itself once recognized this basic tenet of administrative law, when it held: "If the haste necessitated gave rise to unreasonable inconsistencies in the administrative interpretations, . . . then we will readily rectify them." *University of Southern California v. Cost of Living Council,* 472 F.2d 1065, 1069 (T.E.C.A. 1972), *cert. denied,* 410 U.S. 928 (1973). Quite recently, TECA stated, "It is 'of paramount importance that the agency adhere to its own

announced rules (citation omitted),'" *Husky Oil Co. v. DOE,* 3 CCH Energy Management Reporter ¶ 26,110, at 27,016 (August 10, 1978). See also *Office of Communication of the Church of Christ v. FCC,* 560 F.2d 529 (2d Cir. 1977); *Contractors Transport Corp. v. United States,* 537 F.2d 1160, 1162 (4th Cir. 1976); *Frozen Food Express, Inc. v. United States,* 535 F.2d 877 (5th Cir. 1975).[7]

There can be no doubt that FEA interpreted the applicability of the "refiner" definition differently in General Crude's case than in any other case it has considered.[8] Compare *Husky Oil Co. v. DOE, supra,* where an inconsistent agency decision was overturned by the Court. No other agency decision concerning the "refiner" definition has omitted deciding whether the firm's activities "refine covered products" or "blend and substantially change covered products." In fact, as seen at pages 14-20

7. Hastening to affirm the FEA, the TECA relied heavily upon giving "great deference" to agency action, but such deference may be accorded only when agency action is *consistent* with its regulations and related agency interpretations. *Udall v. Tallman,* 380 U.S. 1, 16-17 (1965). One commentator, analyzing TECA's performance, has cited the "great deference" test as the court's primary method for escaping its responsibilities in judicial review. Elkins, the Temporary Emergency Court of Appeals: A Study in the Abdication of Judicial Responsibility, 1978 Duke L. J. 113.

8. The agency decisions rely in part on an interpretation issued to G. E. Kadane & Sons, General Crude's co-owner of the Banning Lease working interest, to support the conclusion that General Crude is a "producer." *G. E. Kadane & Sons,* 3 FEA ¶ 80,516 (Dec. 5, 1976). Based on similar reasoning with the agency decisions to General Crude and having been prepared almost concurrently with General Crude's remedial order action, this interpretation can hardly stand as independent precedent. It suffers from many of the same flaws as are enumerated in this Petition and, in particular, ignores the literal wording of the "refiner" definition.

of this Petition, FEA's argument to TECA and TECA's decision prove that the Remedial Order failed to apply the "substantial change" test. Moreover, in FEA's *Tristate* decision, the agency minutely analyzed the "refiner" definition and found that ". . . the processing of crude oil . . . to produce refined petroleum products and residual fuel oil . . . necessarily involve(s) a substantial change in form", whereupon it held the firm involved to be a "refiner." *Tristate Oil and Asphalt Sales, Inc.,* Interpretation No. 78-22 (June 9, 1978), CCH Enforcement Manual ¶ 56,413. The *Tristate* decision is flatly irreconcilable with the agency decision issued to General Crude. Other agency decisions that applied the "refiner" definition literally to disparate facts include *The Independent Oil Compounders Ass'n,* Interpretation No. 78-33 (July 10, 1978), CCH Enforcement Manual ¶ 56,424; *Ryder System, Inc.,* 1 FEA ¶ 20,742 (Dec. 16, 1974); *McCulloch Gas Processing Corp.,* 1 FEA ¶ 20,180 (Nov. 5, 1974).[9]

No less offensive than the patent inconsistency in regulatory interpretations evidenced by this case is the inconsistency between results achieved by the Remedial Order and the goals of statutes under which FEA operates. Despite TECA's insistence on the narrow scope of its review power, it is still the Court's responsibility to decide whether the agency action is compatible with its congressionally delegated duty. *Morton v. Ruiz,* ___ U.S.___, 94 S.Ct. 1055, 1075 (1976). Where none of

9. The TECA opinion suggests that other agency decisions "consistently" have focused on "business activities" as a test for application of the price regulations. App. A-8. Apart from *Kadane, supra,* n. 8, none of these cases involved application of the agency "refiner" definition, which is at issue here.

the goals sought by the statute is furthered by agency action, the action may safely be overturned. *Id.* As has been shown, enforcement of FEA's Remedial Order will accomplish no purpose promoted by the Congress and will in fact undermine FEA's responsibility to insure supplies of petroleum product, protect independent marketers, and minimize economic distortion.

Faced with a similar failure by an FEA action to fulfill Congressional goals for energy policy, TECA swiftly reversed FEA in *Husky Oil v. DOE, supra.* The goal of "controlling prices," adduced by TECA as *post hoc* justification of the agency action, simply is not enhanced by the Remedial Order to General Crude for two reasons. First, FEA's inconsistent action in permitting Armour Oil Company to sell Product 15 at a residual fuel oil price insulates Armour from having to refund any of the $5 million it will receive from General Crude, thus creating a windfall profit for Armour but no price reduction to the ultimate consumers. Second, FEA, upon congressional approval, de-controlled residual fuel oil in mid-1976 based on findings that no further need for price or allocation controls existed. At least since that date, TECA's *post hoc* defense is misplaced.

With respect to the de-control of residual fuel oil, FEA squarely contradicts its mandate from Congress and its own regulation by attempting to require General Crude to sell Product 15 at crude oil prices. Congress authorized the agency to de-control petroleum products by adding a new Section 12 to the EPAA in 1975. Energy Policy and Conservation Act, § 455, 89 Stat. 950, 965 (1975). Section 12 permits the President (whose authority was exercised by FEA), after following

specified procedures, to exempt products from price and allocation controls "with respect to a class of persons or class of transactions (*including transactions at any market level*) . . ." (Emphasis added.) *Id.* FEA did not exercise its discretion to confine the exemption of residual fuel oil in any way, 10 C.F.R. § 210.35, hence the exemption became effective *at all market levels* and with respect to *all classes of persons.* Having created a broad exemption, FEA cannot at this late date modify the regulation in an *ad hoc,* discriminatory manner against General Crude, while allowing Armour and all other persons dealing in Product 15 to reap the fruits of the exemption. A court should not "defer" to the agency's arrogant disregard of its own regulations.

It must be emphasized that at no point in the agency proceeding did FEA attempt to reconcile or explain the basis for the above-listed inconsistent conduct and interpretations, though requested to do so by General Crude at every stage of the proceedings. FEA has thus displayed a callous disregard of consistency and of the requirement to articulate a rational basis for its action, without which its Remedial Order degenerates into willful, punitive arbitrariness. The inarticulateness of the Remedial Order is also a reflection of its incompatibility with any regulatory goal entrusted to FEA by Congress. Employing an absurdly lenient standard of review, TECA thus affirmed agency action contrary to the decisions of this Court and the generally followed rule of law and inimical to Congressional objectives. From a legal standpoint, TECA's decision was erroneous, and from a policy standpoint, it could be disastrous to the industry regulated by an un-supervised agency.

3. This Court Should Decide The Important Federal Question Whether General Crude Was Entitled To A Formal Hearing.

and

4. Whether A Formal Hearing Was Required Calls Into Question The Validity Of The Agency's Governing Statute.

At the agency appeal proceeding, General Crude requested a hearing if the agency disagreed with certain crucial factual submissions by the company (R. 398 and *supra* 10) substantiating the applicability of the "refiner" regulation to its Banning Lease activity. Specifically, General Crude had tendered evidence of the 1960 and 1973 laboratory analyses and had asserted that these reflected substantial chemical changes. No hearing was permitted, consequently, General Crude assumed those facts were not disputed and, in fact, FEA stipulated their existence before the District Court. In the absence of a formal adversary hearing, no formal record was compiled by FEA, the agency was not compelled to set out the evidence supporting its position or affirmatively to challenge General Crude's evidence, and General Crude was not afforded a right of cross-examination to test disputed assertions of an intervenor or probe the agency's position.

The most obvious disadvantage of FEA's haphazard informality occurred when the agency, on appeal before TECA, suddenly undertook to disavow the hitherto uncontested and stipulated facts.[10] With utter disregard of the "record" facts, FEA claimed, and TECA "found,"

10. Lest this be thought the only procedural irregularity, two other noteworthy deficiencies arose. First, General Crude had to supplement the agency "record" in the District Court with copies of a letter written by the President of Armour Oil Company to an FEA official, which had strongly supported the company's position. FEA's "record" had omitted this letter. Amended R. 829H-I. Second, the parties' briefs before the courts indicate recurrent disputes over the meaning and trustworthiness of submissions by an intervenor, Sunland Refining Company, against General Crude. If believed, Sunland's evidence implied that it bought and used Product 15 as "crude oil," but General Crude questioned Sunland's veracity (R. 528, Amended R. 829D-E). Of course, the company never had an opportunity to test Sunland's witnesses by cross-examination.

that the only difference between Banning crude oil and Product 15 was an API gravity change and that this change was "insubstantial." General Crude's factual underpinning for its contention concerning the "refiner" definition was destroyed by this highly dubious and unsupported TECA interpretation of a sophisticated point of petrochemistry. Had the administrative proceeding been more formal, at least requiring the presentation by both sides of their supporting witnesses and data subject to cross-examination, FEA could not have succeeded in creating a material factual dispute in the appellate court.

TECA's brusque denial of some kind of formal hearing to General Crude violates this Court's decision in *Wong Yang Sung v. McGrath,* 339 U.S. 33 (1950). The Court there held that the Administrative Procedure Act's adjudication provision, 5 U.S.C. § 554(a) (1970), which requires a formal hearing, applies as a matter of constitutional due process to all agency adjudications held by compulsion. See Friendly, "Some Kind of Hearing," 123 U.Pa. L.Rev. 1267, at 1310 n. 218 (1975). These safeguards are particularly necessary in agency proceedings that are convened in part to impose substantial penalties against a regulated company such as General Crude in this case.

FEA will argue that it was exempted by statute from the adjudication provision of the Administrative Pro-

cedure Act,[11] but that argument fails for three reasons. First, the purported Congressional exemption is invalid if, as *Wong Yang Sung* implies, it conflicts with the Constitution. Second, Congress has stated since it adapted this portion of the statute to FEA that it "never intended to deprive parties of due process of law,"[12] hence the exemption must be interpreted to comply with Congressional

11. See Section 207 of the Economic Stabilization Act of 1970, incorporated by § 5(a)(1) of the EPAA.

12. Conference Report No. 95-539, 95th Cong., 1st Sess., reprinted in [1977-2] U.S. Code Cong. & Admin. News 956-57. The Department of Energy Organization Act was amended to afford litigants before the agency the safeguards of a formal proceeding, although they only apply to actions commenced *after* the effective date of the Act. Section 503, 42 U.S.C. § 7193 (1977 Supp.). In cosponsoring this amendment, Senator Stone ruefully commented on the prior state of FEA's procedural insensitivity:

> ". . . I joined today in cosponsoring an amendment to S. 826, the Department of Energy Organization Act, . . . This amendment would establish statutory due process procedures by affording an alleged wrongdoer a hearing on the record. Under these procedures, a party will not have an opportunity at an agency hearing to present its case to an independent board, to rebut evidence presented against it, to confront adverse witnesses and to develop a complete record for a fair and equitable judicial review of the final Department order. This notion of due process is securely engrained in our administrative judicial process and there is no valid reason why the Department of Energy should not follow these basic safeguards.
>
> *Under current FEA procedure, these safeguards have not been fully applied in the compliance and enforcement process. Congress never intended to allow FEA to depart from these requirements of fundamental administrative due process.* With the transition from a short-term, administrative agency to a permanent, cabinet-level Department of Energy which will be authorized to develop and administer a long-term comprehensive national energy program, the Department must accept the responsibility of insuring administrative due process rights by affording a full and complete hearing on the record in Department adjudicatory hearings. *Congress must now pass this amendment to clearly re-affirm its desire for fundamental due process in the administrative arena."*

123 Cong. Rec. S7937 (daily ed., May 18, 1977) (Emphasis supplied.)

intent to permit full and fair airing of cases before the agency.

Third, on the facts of *this* case, the lack of a formal hearing deprived General Crude of the opportunity to pin down beyond challenge the material facts: that natural-state Banning crude oil (prior to *in situ* combustion) is not the same as Product 15, which *is* residual fuel oil, and that the company's entire activity at the Banning Lease accomplishes substantial chemical changes to "refine" residual fuel oil from crude oil, A formal record will ensure that FEA cannot subseqently take *post hoc* potshots at isolated technical data in an effort to confuse the courts as to their significance. This Court has recently held that a hearing may be constitutionally required to resolve disputed material facts between a private citizen and a government agency, *Codd v. Velger*, ____U.S.____, 97 S.Ct. 882 (1977), and FEA's *post hoc* arguments have indubitably raised serious fact issues which General Crude should have been permitted to address. See also, *Independent Bankers Association of Georgia v. Board of Governors of F.R.S.*, 516 F.2d 1206 (D.C. Cir. 1975); *Blackwell College of Business v. Attorney General*, 454 F.2d 928 (D.C. Cir. 1971).

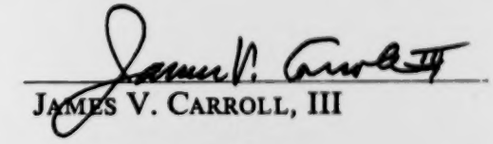
Recent decisions of this Court have indicated some flexibility in the standards that hearings may satisfy while comporting with the "due process" clause of the Constitution. See, e.g., *Matthews v. Eldridge*, 424 U.S. 319, 334-35 (1976). None of these cases, to Petitioner's knowledge, dealt with a classic adjudicative action by an agency against a private party, from which enormous monetary refund orders as well as civil and criminal penalties could follow. General Crude has been the subject of such an adjudicative proceeding and the victim

of its excessive informality. General Crude submits that it was constitutionally or statutorily entitled to a more formal proceeding before FEA, even under the rule of *Matthews v. Eldridge, supra,* affording at least a formal transcript, cross-examination of witnesses, and the opportunity to rebut agency evidence.

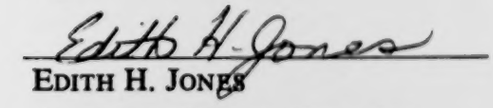
From the foregoing discussion, it is apparent that important questions of constitutional and statutory due process of law inhere in FEA's failure to accord a formal hearing to General Crude, despite TECA's decision to the contrary. Resolution of these questions will determine how and how fairly FEA will handle literally thousands of adjudicative refund and penalty proceedings.

CONCLUSION

Petitioner General Crude Oil Company respectfully submits that a writ of certiorari should issue and that the decision of the Temporary Emergency Court of Appeals reversing a summary judgment for Petitioner should be reversed.



JAMES V. CARROLL, III



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Attorneys for Petitioner
General Crude Oil Company

Dated: December 9, 1978.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that three copies of the foregoing Petition for a Writ of Certiorari have been served upon the Solicitor General, Department of Justice, Washington, D.C. 20530, as required by Rules 21.3 and 33 of the Supreme Court Rules; that three copies have been served upon the Department of Energy; and that one courtesy copy has been served upon Sunland Refining Corporation through its counsel of record William A. Long, at Latham, Watkins & Hills, 1625 K Street, N.W., Washington, D.C. 20006.

JAMES V. CARROLL, III

APPENDIX I

TEMPORARY EMERGENCY COURT OF APPEALS
OF THE UNITED STATES

No. 5-29

GENERAL CRUDE OIL COMPANY,
Plaintiff-Appellee,

v.

DEPARTMENT OF ENERGY,
Defendant-Appellant,

and

THE UNITED STATES OF AMERICA,
Counterclaimant-Appellant.

Appeal from the United States District Court for the Southern District of Texas, Houston Division

(No. CA 76-H-1008)

(Argued August 31, 1978 Decided October 12, 1978)

ARTHUR E. GOWRAN, with whom Robert G. Heiss, Department of Energy, Washington, D.C.; and Dina R. Lassow, with whom Dennis G. Linder and Barbara Allen Babcock, Assistant Attorney General, Department of Justice, Washington, D.C., were on the brief for the Appellant.

JAMES V. CARROLL, III, with whom Edith H. Jones, Andrews, Kurth, Campbell & Jones, Houston, Texas, were on the brief for the Appellee.

HUGH STEVEN WILSON, WILLIAM A. LONG and JOHN S. CHANG, Latham, Watkins & Hills, Washington, D.C., were on the brief for Sunland Refining Corporation, Amicus Curiae.

Before ESTES, JOHNSON, and GEWIN, Judges.

ESTES, Judge.

General Crude Oil Company (General Crude) is the owner of a 50% working interest in the Banning Lease in the West Newport Field, in Newport Beach, California, which it purchased in 1966 from G. E. Kadane and Sons (Kadane). Kadane remains a 50% working interest owner, while General Crude has been the operator of the lease since 1966. Production on the lease by Kadane began in 1948; however, due to a rapid decline in production and low estimates of ultimate oil recovery, an enhanced recovery method, in situ combustion, was begun in 1958.

In situ combustion, or fire flooding, involves the ignition and controlled burning under controlled pressure of part of the heavy crude oil in the reservoir. This process cracks the hydrocarbons into lighter fractions, thereby altering the chemical composition of the crude oil from the natural state in which it existed in the underground reservoirs. *G. E. Kadane and Sons,* 3 FEA ¶ 80,516 (December 5, 1975). The chemical change is insubstantial.

By letter of December 4, 1974, Kadane requested an interpretation of FEA pricing regulations as they applied to the production from the Banning Lease. The FEA determined that although the product might arguably satisfy the technical specifications of residual fuel oil, it had been sold to Standard Oil of California (SOCAL) as crude oil for use as feedstock and that to apply the new item price rule would require a "radical departure from the historical treatment of the Banning Lease production by Kadane itself." Interpretation No. 75-29,

July 12, 1975. The interpretation was affirmed on administrative appeal by FEA's Appeal Decision and Order of December 5, 1975, which concluded that the proper classification of Kadane's Banning Lease operation under the pricing regulations is the production of domestic crude oil; that the production from the Banning Lease is "crude oil" and Kadane is a "producer" of "crude oil" within the meaning of FEA's pricing regulations. *G. E. Kadane and Sons,* 3 FEA ¶ 80,516.

General Crude sold its share of the crude oil production from the Banning Lease to SOCAL until December 1, 1973. On May 18, 1973, General Crude provided SOCAL with six months notice of cancellation of their contract so that it might secure a higher price for its share of the Banning Lease production. On November 15, 1973, General Crude contracted with Armour Oil Company, (Armour) to supply that company with residual fuel oil at a price higher than General Crude had been receiving from SOCAL. General Crude subsequently installed certain above-ground treating and blending facilities on the Banning Lease, at a cost of approximately $10,000, for the purpose of blending non-cracked reservoir fluids with the cracked product in order to produce what it called "Product 15" for sale to Armour. General Crude has priced "Product 15" under the refiner price rules in 10 C.F.R. §212 and since December, 1973, has sold its share of the Banning production for use as residual fuel oil. Kadane, however, has continued to sell its share of such production to SOCAL as crude oil at a price determined pursuant to the producer price rules, in accordance with its historical practice and the FEA Appeal Decision and Order in *G. E. Kadane and Sons,* 3 FEA ¶ 80,516 (December 5, 1975). R. 344-355.

Following the issuance of a Notice of Probable Violation (NOPV) to General Crude on October 17, 1975, citing violations of the pricing regulations in 10 C.F.R. Part 212 in the pricing of "Product 15," the FEA, on May 21, 1976, issued a Remedial Order determining that "Product 15" should have been priced in accordance with the producer price regulations. The Remedial Order was based on the findings that the product had been treated historically as crude oil, the product met the regulatory specifications for crude oil, the firm met the regulatory definition of producer in 10 C.F.R. § 212.31, and the producer pricing provisions under Part 212 were the most suitable for the proper price of the product.

The Remedial Order was affirmed on appeal upon a finding that the firm had violated Cost of Living Council and FEA pricing regulations by charging refiner prices for its share of the Banning Lease production. *General Crude Oil Company,* 4 FEA ¶ 80,552 (October 22, 1976). The FEA determined that the in situ combustion technique is a manner of extracting crude oil, rather than a refining process. The agency reasoned that even though the process produces an incidental alteration in the chemical composition of the substance, the subsequent treating and blending do not substantially alter the nature of the product after its emergence from the ground, nor do they represent the complexity and sophistication normally associated with refining.

The agency further found that the product had been treated historically as crude oil and was denominated as residual fuel oil only after the promulgation of the CLC regulatory programs.

General Crude appealed the FEA Appeal Decision and Order to the United States District Court for the Southern

District of Texas, where the case was heard on the parties' cross motions for summary judgment on December 13, 1977. On March 14, 1978, the District Court entered its Memorandum Decision and Judgment granting General Crude's Motion for Summary Judgment. The court concluded that "Product 15" met the definitions of crude oil and residual fuel oil contained in 10 C.F.R. § 212.31, and that General Crude's activities in making "Product 15" should be considered refining because "General Crude changes a raw, unusuable product to residual fuel oil suitable for use by an ultimate consumer without further treatment and sells Product 15 for use as a residual fuel oil." R. 1094. The District Court further found that the "FEA's decision is inherently arbitrary because it is not consistent with FEA regulations, it is directly contrary to the policy objectives of the Emergency Petroleum Allocation Act of 1973 and it contravenes Congressional intent as expressed in the EPAA." R. 1094. Upon motion of General Crude to alter or amend the judgment, the District Court, on May 12, 1978, supplemented its March 14, 1978 Memorandum with findings that the "Federal Energy Administration's finding that General Crude Oil Company is a 'producer' of 'crude oil' on the Banning Lease is not supported by substantial evidence" and that the "agency's Remedial Order to General Crude Oil Company is in excess of agency authority because it irreconcilably conflicts with agency regulations and Congressional and statutory directives, while failing to achieve any purpose entrusted to the agency." R. 1114. On April 13, 1978, the Department of Energy (DOE)[1]

1. Pursuant to the Department of Energy Organization Act, Public Law 95-91, August 4, 1977, 42 U.S.C. § 7111 et seq., and Executive Order No. 12009, 42 Federal Register 46267, September 15, 1977, the Department of Energy assumed the duties and functions of the FEA.

and the United States of America, counterclaimant, filed a notice of appeal from the final judgment entered on March 14, 1978, holding the May 21, 1976 Remedial Order and the October 22, 1976 Appeal Decision and Order invalid.

The Department of Energy states the issue on appeal as:

> Whether the District Court erred in declaring invalid and enjoining the enforcement of a Remedial Order and Appeal Decision and Order issued by the Federal Energy Administration ("FEA").

and presents the following questions:

> 1. Whether the District Court erred in finding that the May 21, 1976 Remedial Order ("Remedial Order"), as affirmed by the October 22, 1976 Appeal Decision and Order ("Appeal Decision"), which determined that the operator of a lease using an *in situ* combustion process is subject to the producer, rather than the refiner, price rules, is unsupported by substantial evidence.
>
> 2. Whether the District Court erred in finding that the Remedial Order, affirmed by the Appeal Decision, in inherently arbitrary because it contravenes the policy objectives of the Emergency Petroleum Allocation Act of 1973 ("EPAA") and the Congressional intent behind the EPAA.[2]

According to General Crude:

> The issue is whether the District Court erred by declaring invalid and enjoining the enforcement of FEA's Order that would require General Crude to sell Product 15 under a "crude oil" price.

2. Appellants' Brief, 1-2.

and the questions presented are:

> (1) Whether the FEA's conclusion that General Crude is a "producer" of "crude oil" rather than a "refiner" of "residual fuel oil" at the Banning Lease under its regulations is unsupported by substantial evidence or exceeds the agency's authority.
>
> (2) Whether the administrative procedures employed by FEA in handling General Crude's Remedial Order and Appeal proceedings comported with a "substantial evidence" standard of review or with constitutional due process.[3]

From 1966 through November, 1973, General Crude sold all of its crude oil production to SOCAL for use as feedstock. As required by the CLC regulations, General Crude certified to SOCAL that the Banning Lease production was crude oil. While General Crude then made a new contract with Armour Oil Company for the sale of the product as residual fuel oil, Kadane continued to sell its share of production as crude oil to SOCAL. General Crude's price increase to Armour coincided with the CLC's $1 increase in the ceiling price of old oil.

The petroleum industry views in situ combustion as a method of production, as Congress did in amending the Emergency Petroleum Allocation Act of 1973 (EPAA) to add § 8, 15 U.S.C. § 757 (1976 Supp.). The Conference Report to that enactment stated: "A special need to encourage expanded use of high cost, enhanced recovery techniques has led the conferees to provide that this category of production be given high priority consideration in distribution of any price increases which may be permitted by reason of the removal of the 3

3. Appellee's Brief, 1-2.

percent limitation on the production incentive factor." 2 CCH Energy Management ¶ 10,521 at 10,478. In General Crude's case, the enhanced recovery method is used for the primary purpose of extracting the crude oil from the reservoir. Any alteration in the composition of the substance is merely incidental to the primary operation. Furthermore, the FEA has followed a consistent practice of focusing on business activities in determining application of its price regulations. *G. E. Kandane & Sons,* 3 FEA ¶ 80,516, *Varibus Corp.,* 4 FEA ¶ 83,152, *International Trading and Transport, Ltd.,* 3 FEA ¶ 87,031, *LaTex Barge, Inc.,* 4 FEA ¶ 87,004, and *Maurice L. Brown Co.,* 3 FEA ¶ 83,196. An examination of the firm and its activities reveals that General Crude Oil Company is a producer of crude oil or, more specifically, is engaged in the business of extracting crude oil from underground reservoirs.

In *Kadane, supra,* the FEA recognized that the situ process does crack the hydrocarbons into lighter fractions and thus alters the chemical composition of the crude oil. 3 FEA 80,516. General Crude blends this cracked substance with non-cracked reservoir fluids, after which the product is transferred to a treating facility for the removal of water. As the FEA stated in its Appeal Decision and Order of October 22, 1976, these blending and treating "operations are rather rudimentary and certainly do not involve the complexity and sophistication which are usually associated with a refining process." R. 696. Since construction of the treatment facility cost the firm only $10,000, the facility "hardly represents the level of investment normally associated with a new refinery project." R. 696. The FEA considered it to be nothing more than a filter of contaminants in preparing

the oil extracted for shipment to market. The blending and treating of the cracked and non-cracked oil produced by the situ combustion operation do not substantially change the nature of the product after its emergence from the ground and do not constitute refining within the meaning of 10 C.F.R. § 212.31.

Further support for this result can be drawn from the Congressional mandate to the FEA contained in § 8(a) of the EPAA to control all first sales of crude oil, excluding stripper well lease production: " . . . The President shall promulgate and make effective an amendment to the regulations under § 4(a) of this Act which regulation, as amended, shall establish ceiling prices (or the manner of determining ceiling prices) applicable to any first sale of crude oil produced in the United States . . ."

Section 4(b) of the EPAA lists nine objectives which the implementing regulations are to achieve "to the maximum extent practicable." Because these objectives are collective goals, they must all be balanced, and no one objective may be elevated to the level of a mandatory duty. *Pasco v. FEA,* 525 F.2d 1391, 1396-7 (TECA 1975); *Mobil Oil Corp. v. FEA,* 566 F.2d 87 (TECA 1977). In finding the FEA decision violative of agency regulations and EPAA policies, the District Court determined that the "FEA's decision tends to discourage expansion and continued operation of the in situ combustion project at the Banning Lease which if discontinued would result in a potential loss of 6.5 million barrels of Product 15," R. 1094. This contravenes § 4(b)(1)(D) of the EPAA, which calls for the "preservation of an economically sound and competitive petroleum industry; in-

cluding the priority needs to restore and foster competition in the producing, refining, distribution, marketing, and petrochemical sectors of such industry." The District Court also found that upon termination of the in situ combustion process, the Banning crude oil would needlessly occupy refinery space, in contrast to the § 4(b)(1)(H) and (I) objectives of economic efficiency and of minimization of economic distortion, inflexibility, and unnecessary interference with market mechanisms. The court further concluded that "Armour, an independent marketer, would be forced to withdraw from the marketing of Product 15," R. 1094, contrary to § 4(b)(1)(D), above, which also calls for the preservation of the "competitive viability of . . . non-branded independent marketers and branded independent marketers." In making these findings, however, the District Court overlooked the objective of § 4(b)(1)(F), which provides for "equitable distribution of crude oil, residual fuel oil, and refined petroleum products at equitable prices among all regions and areas of the United States and sectors of the petroleum industry, including independent refiners, small refiners, nonbranded independent marketers, branded independent marketers, and among all users." Clearly, the orders attacked achieve this objective.

During the administrative proceedings in this case, the FEA considered General Crude's argument that the agency's determination in the Remedial Order conflicted with national energy objectives to the extent that it would produce adverse economic consequences, including abandonment of the Banning in situ operation. In its October 22, 1976 Appeal Decision and Order, 4 FEA ¶ 80,552 at 80,714 FEA stated, inter alia:

> . . . Even if General Crude's economic predictions were accurate, they nevertheless do not furnish a basis for sustaining General Crude's assertion that the conclusions reached in the Remedial Order are erroneous. As we have already stated, the Deputy Assistant Administrator correctly concluded in the Remedial Order that the producer price rules apply in the present situation, and General Crude must comply with the Price Regulations as written. If as the firm asserts, it will incur a hardship or inequity as a result of the proper application of the producer rules, then the appropriate remedy lies in an Application for Exception. In fact, on September 21, 1976 the FEA granted General Crude exception relief which permits it to sell a portion of the crude oil which it produces from the Banning Lease at upper tier prices. *General Crude Oil Co.*, 4 FEA ¶ 83,104 (September 21, 1976).

Title 10 C.F.R. Part 205 provides the procedure for obtaining exception relief if a firm would suffer serious hardship or gross inequity from application of the producer price rules. As shown above, General Crude has availed itself of this procedure, *General Crude Oil Co.*, 4 FEA ¶ 83,104 (9-21-76). The firm was permitted to sell a portion of its production from the Banning Lease at upper-tier prices. DOE will consider exception relief in the light of the opinion in *Husky Oil Company v. Department of Energy*, ____F.2d____ (TECA No. 10-18, decided August 10, 1978).

The voluminous record reveals that the most that can be fairly said of General Crude's claim of stipulations or agreements made by Ms. Linda Pence, appellants' counsel, is that Ms. Pence agreed and the agencies conceded that the oil produced at the Banning Lease was

residual fuel oil in the sense that it met the definitions and technical specifications of both "residual fuel oil" and "crude oil." She did not stipulate or agree that such oil was not "crude oil" and she did not stipulate or agree that General Crude was a "refiner" of such oil under the CLC/FEA Regulations. On the contrary, she argued that the agencies correctly classified General Crude as a "producer" of "crude oil" at the Banning Lease rather than a "refiner" of "residual fuel oil" under the agency pricing regulations.

At the time Kadane discovered oil on the Banning Lease, in 1943, it was sole owner and operator of the lease. In 1966, General Crude acquired one-half of the working interest in the lease and became operator of the lease. During all of this time, every document and paper evidencing the sale and delivery of the oil production from this lease referred to it as crude oil, until after the price of such production was controlled under acts of Congress and the implementing agencies (CLC and successors, FEA and DOE). In their dealings with these agencies, both Kadane and General Crude referred to such production as "crude oil" up to the time when General Crude, then operator of the lease, decided, after oral consultation with an IRS agent,[4] to cancel its con-

4. Appendix "A" hereto, copy of a letter of November 9, 1973 (R. 278-279), from General Crude's attorney, James V. Carroll, III, to Darrell Chandler, vice president of General Crude, "Re: Price Controls Questions," shows General Crude's awareness that it could obtain a ruling from the Cost of Living Council on whether the Banning oil production "could be sold as a 'new item' by a 'refiner'. . . . Gary said that he thought the theory was tenable, without expressing an opinion as to whether or not it would be sustained by the Cost of Living Council. . . .He seemed to think that a substantial delay might result if the Company sought to obtain a ruling from the Cost of Living Council prior to making a sale . . ."

tract with SOCAL for this production as crude oil and obtain a purchaser (Armour) who could and would resell it as "residual fuel oil." The record shows that this product was crude oil, even though it also met the specifications of residual fuel oil, and that the only difference in the product resulting from the recovery processes used to extract and deliver the oil from the pre-in situ recovery technique was a change in the gravity of the crude oil from 15° to 17° API. General Crude has never operated as "what is traditionally known as a refiner in the petroleum industry." R. 272. Clearly, the FEA had a rational basis for application of the producer pricing rules to General Crude Oil Company's sale of its production from the Banning Lease.

General Crude's contention regarding the question of whether the administrative procedures employed by FEA comported with a "substantial evidence" standard of review or with constitutional due process is without merit. *Atlantic Richfield Co. v. FEA*, 556 F.2d 542, and cases cited in footnote 10, page 546; and see *Mapco, Inc., et al. v. Carter, et al.* (TECA 1978), 573 F.2d 1268, cert. denied, ____U.S.____, 98 S.Ct. 3090 (June 19, 1978).

It is well established that great deference must be accorded the interpretations of statutes, implementing regulations, and orders by the administering agency, see *Pasco, supra, at* 1400-1404; thus the judicial review of an agency decision and order is necessarily limited. As this court noted in *Pasco, supra*, at 1400:

Subparts A and B of Part 155 of the CLC Regulations later FEA Regulations 10 C.F.R. §§ 205.80-205.86, contain the procedures to be used for requesting agency interpretations, which do not include oral interpretations. *Atlantic Richfield Co. v. FEA*, 556 F.2d 542, 550-551 (TECA 1977), explains the procedure. General Crude did not request such an interpretation as did Kadane.

> . . . In reviewing the discharge of an agency's function in interpreting the Act, promulgating regulations thereunder and applying and enforcing such regulations, this court has recognized that where administrative control has been congressionally authorized, the "judicial function is exhausted when there is found to be a rational basis for the conclusions approved by the administrative body." *Pacific Coast Meat Job. Ass'n, Inc. v. Cost of Living Coun.*, 481 F.2d 1388, 1391 (TECA 1973), which was quoting from *Miss. Valley Barge Co. v. United States*, 292 U.S. 282, 286-287 . . .

This principle of deference to agency determination was again discussed in *Cities Service v. FEA*, 529 F.2d 1016, 1026 n. 16 (TECA 1975), where the court quoted from the Supreme Court opinion in *Railroad Com. v. Rowan & Nichols Oil Co.*, 310 U.S. 573, 580-584 (1940):

> [S]uch cases are only episodes in the evolution of adjustment among private interests and in the reconciliation of all these private interests with the underlying public interest in such a vital source of energy for our day as oil. Certainly so far as the federal courts are concerned the evolution of the formulas belongs to the Commission and not to the judiciary. . . . A controversy like this always calls for fresh reminder that courts must not substitute their notions of expediency and fairness for those which have guided the agencies to whom the formulation and execution of policy have been entrusted. . . . It is not for the federal courts to supplant the Commission's judgment even in the face of convincing proof that a different result would have been better.

In *Basin, Inc. v. Federal Energy Administration*, 552 F.2d 931, 934 (TECA 1977), this court stated:

> . . . . "It is a well settled principle that the courts place great weight on the interpretations given to statutes and regulations by those agencies charged with the responsibility of administering them." [citing cases]

The *Basin* opinion, at 934, *supra*, quoted the following from *Condor Operating Co. v. Sawhill*, 514 F.2d 351 (TECA 1975), *cert. denied* 421 U.S. 976, 95 S.Ct. 1975, 44 L.Ed.2d 467:

> . . . "Where the obvious intent of Congress is to give the President and his delegates broad power to do what reasonably is necessary to accomplish legitimate purposes rendered necessary by a recognized emergency, and regulations are fashioned to implement the Congressional mandate, the court should not interfere with the prerogative of the agency to select the remedy which for rational reasons is deemed most appropriate."

Mobil Oil Corp. v. Federal Energy Administration, 566 F.2d 87, 93 (TECA 1977), states:

> . . . Agency action taken in pursuit of a legitimate statutory goal enjoys a "presumption of validity," and he who would upset it carries a "heavy burden." *FPC v. Texaco, Inc.*, 417 U.S. 380, 389, 94 S.Ct. 2315, 41 L.Ed.2d 141 (1974). . . .

In *Pasco, Inc. v. Federal Energy Administration*, 525 F.2d 1391, 1394 (TECA 1975), this court said:

> In reviewing the exercise of that authority, it must be remembered that the "[e]xercising of the administrative authority and the accomplishment of purposes enumerated by Congress under the recognized

emergency conditions are exceedingly complicated undertakings." *Condor Operating Company v. Sawhill,* 514 F.2d 351, 359 (TECA 1975), *cert. denied,* 421 U.S. 976, 95 S.Ct. 1975, 44 L.Ed.2d 467 (1975). The broad mandate for the equitable allocation of crude oil at equitable prices combined with the rapid rise in world oil prices left the FEA with a "gargantuan task."[6] As stated in *Condor Operating Company v. Sawhill, supra,* at p. 359:

> The urgency of the challenge confronting the agency upon the passage of the Emergency Petroleum Allocation Act already has been recognized.

6. This phrase was similarly applied to the burden imposed on the Cost of Living Council under the Stabilization Act which, like the Allocation Act, was an extremely broad delegation of authority by Congress to the Executive Branch under recognized emergency conditions. *University of Southern Cal. v. Cost of Living Council,* 472 F.2d 1065, 1068 (TECA 1972).

The situation of the CLC and FEA administering the Economic Stabilization Act and the Emergency Petroleum Allocation Act of 1973, as amended, was recognized by subsequent decisions of our court in *National Helium Corp. v. FEA,* 569 F.2d 1137, 1144 (TECA 1977), and *Getty Oil Co. v. DOE,* ____F.2d____ (TECA No. 10-14, decided July 18, 1978).

In *Amtel, Inc. v. Federal Energy Administration,* 536 F.2d 1378, 1383 (TECA 1976), this court stated:

> . . . In *Consumers Union of U. S., Inc. v. Cost of Living Council,* 491 F.2d 1396, 1403 n. 2 (TECA 1974), *cert. denied,* 416 U.S. 984, 94 S.Ct. 2387, 40 L.Ed.2d 761 (1974), this court quoted from *Dandridge v. Williams,* 397 U.S. 471, 485, 90 S.Ct. 1153, 1161, 25 L.Ed.2d 491 (1970), which stated:

> "The problems of government are practical ones and may justify, if they do not require, rough accommodations—illogical, it may be, and unscientific."
>
> By requiring the attainment of the specified objectives of the Allocation Act "to the maximum extent *practicable*" (emphasis added), 15 U.S.C. § 753(b)(1) (1976 Supp.), Congress recognized that the objectives were to a certain extent inconsistent and intended that the FEA would exercise its discretion in achieving a workable balance among them.

The District Court did not accord FEA's findings the judicial deference to which they were entitled under the law. *Southern Union Production Co. v. FEA,* 569 F.2d 1147, 1152 (TECA 1978).

The decisions and orders of the FEA under attack were authorized by law, supported by substantial evidence, rationally based, and were not arbitrary, capricious, erroneous, or otherwise invalid.

The judgment of the District Court is clearly erroneous. It is hereby reversed and the case remanded with directions to vacate the District Court's March 14, 1978 Judgment granting plaintiff General Crude's Motion for Summary Judgment and to grant defendants' motion for summary judgment and for further proceedings consistent herewith.

IT IS SO ORDERED.

Appendix "A"

November 9, 1973

Mr. Darrell Chandler
General Crude Oil Company
P. O. Box 2252
Bank of the Southwest Building
Houston, Texas 77001

Re: *Price Controls Questions*

Dear Darrell:

I spoke with Gary Dossett, Petroleum Regulations Expert at the IRS Office, regarding General Crude's proposed California fuel oil sale. I told Gary that the Company recently learned that the oil satisfied the specifications for "Bunker C" or "number six fuel oil". The Company engages in a secondary recovery procedure which involves the burning of gas in the formation so as to drive oil to the other wells located at the perimeter. A result of the secondary recovery operation is to "cook" the oil and to drive off certain volatile components. As a result of this cooking operation, the oil which is produced from that field meets the specifications of number six fuel oil or Bunker C fuel oil.

I told Gary that the Company feels that it would be justified in taking the position that the oil that was produced from that field could be sold as a "new item" by a "refiner", based on the theory that the Company has changed the characteristics of the oil in connection with the secondary recovery operation and that it had produced a specification product which needed no further "refining" in order to be sold to industry as fuel oil. Gary said that he thought the theory was tenable, without expressing an opinion as to whether or not it would be sustained by the Coast of Living Council. He indicated

that the Cost of Living Council had been very slow in issuing determinations requested by the Internal Revenue Service. He seemed to think that a substantial delay might result if the Company sought to obtain a ruling from the Cost of Living Council prior to making a sale under the theory underlined above.

If you have any questions regarding this matter, please contact me.

Very truly yours,

JAMES V. CARROLL, III

94/sj

APPENDIX II

IN THE
UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

CIVIL ACTION NO. 76-H-1108

GENERAL CRUDE OIL COMPANY

v.

FEDERAL ENERGY ADMINISTRATION
AND
THE UNITED STATES OF AMERICA

MEMORANDUM

This cause came before the Court on cross motions for summary judgment. Oral argument was heard on October 13, 1977. The controversy herein concerns the propriety of application of an FEA rule to plaintiff, General Crude Oil Company (hereinafter General Crude). This Court has jurisdiction of this matter by virtue of § 5(a)(1) of the Emergency Petroleum Allocation Act of 1973, as amended, 15 U.S.C. § 754.

Plaintiff operates an in-situ combustion enhanced recovery project at the Banning Lease in Orange County, California. In-situ combustion is a sophisticated tertiary recovery technique whereby part of the crude oil in the reservoir is subjected to controlled burning at a regulated pressure. In its natural state in the reservoir the crude oil under the Banning Lease is not residual fuel oil and

is not suitable for use as residual fuel oil. As a result of the underground in-situ combustion process the chemical composition of the crude oil is changed from its natural state in that the hydrocarbons are "cracked" into lighter fractions. The "cracked" reservoir crude oil is then blended above the ground and treated to produce Product 15, which satisfies the technical specifications for residual fuel oil. Also, Product 15 does not require further refining, which fact is evidenced by the direct consumption of Product 15 by the U. S. Navy, U. S. Air Force, U. S. Marine Corps and several VA hospitals. Thus, the cracking and blending process involved serves as a refining technique.

In its May 21, 1976 Remedial Order, FEA found that General Crude's sales of Product 15 from the Banning Lease were sales of "crude oil" by a "producer" as those terms are defined in 10 C.F.R. § 212.31. Pursuant to those determinations, the FEA ordered General Crude: (1) to refund to Armour the sum of $1,076,465.76 for sales from December 1, 1973 through June 30, 1975; (2) to recalculate its prices pursuant to 10 C.F.R. § 212.73 and § 212.74 for the period of July 1, 1975 through the then present date; (3) to refund with interest at specified rates the excess monies collected from Armour; and (4) to reduce its prices prospectively to Armour. In its Appeal Decision and Order dated October 22, 1976, FEA denied General Crude's appeal argument that it should be permitted to price Product 15 as a "residual fuel oil" pursuant to the "refiner" price rule as those terms are defined in 10 C.F.R. § 212.31. In a Supplemental Order dated July 8, 1976, FEA granted General Crude's application for a stay of the refund and price reduction obligations of the Remedial Order and

permitted establishment of an escrow account into which General Crude would place the monies ordered to be refunded by the Remedial Order. The escrow account and the terms of the July 8, 1976 stay were continued during the pendency of judicial review in the form of a Stipulation Agreement executed by the parties on November 10, 1976, and filed with the Court.

Product 15 satisfies both the definition of "crude oil" and the definition of "residual fuel oil" as found in 10 C.F.R. § 212.31. The dispute herein, thus, rests solely on the question of whether General Crude's activities in making Product 15 satisfy the definition of "refiner" in 6 C.F.R. § 150.52 and 10 C.F.R. § 212.32 or the definition of "producer" in 6 C.F.R. § 150.352.

The FEA argues that General Crude is a "producer" rather than a "refiner" because (1) production on nearly all crude oil properties typically involves some treatment of the crude oil; (2) crude oil itself may be used in certain instances as heavy fuel oil like Product 15 without any treatment, and (3) the essential operation in which General Crude historically is engaged at the Banning Lease is the extraction of crude oil. The arguments put forth by the FEA ignore the facts that: (1) General Crude substantially changes the nature of the Banning product by "cracking" the hydrocarbons into lighter fractions, and thereafter dehydrating and blending the "cracked" product with the original crude above the ground to produce Product 15, which activities put General Crude within the "refiner" definition in 10 C.F.R. § 212.31 as one who "blends and substantially changes covered products"; (2) 100% of Product 15 has been sold as residual fuel oil since April of 1975 as the economics of the oil industry made such action imperative; and (3) the in-situ combustion will be terminated for economic insupportability if General Crude is not given "refiner" status. The FEA is saying essentially that General Crude does not perform sufficiently complicated processing to qualify as a refiner. The FEA also argues that General Crude cannot now change its prior classification of producer to refiner for this one product even though the end use of the product has changed; the market General Crude sells to is different from its former crude oil market; and the project cannot be conducted at a profit under "producer" price controls. Such reasoning on the part of the FEA contradicts the realities of the situation—General Crude changes a raw, unuseable product to residual fuel oil suitable for use by an ultimate consumer without further treatment and sells Product 15 for use as a residual fuel oil. Further, the FEA's Remedial Order to General Crude contravenes the underlying policies of the Emergency Petroleum Allocation Act of 1973, as amended, 15 U.S.C. § 754 et seq in the following ways.

a) FEA's decision tends to discourage expansion and continued operation of the in-situ combustion project at the Banning Lease which if discontinued would result in a potential loss of 6.5 million barrels of Product 15. contrary to § 4(b)(1)(D)(2) of the EPAA, as amended. 15 U.S.C. § 754 et seq;

b) With the in-situ combustion terminated, the Banning Product must needlessly occupy refinery space, contrary to § 4(b)(1)(H) and (I); and

c) If the in-situ combustion is discontinued, Armour, an independent marketer, would be forced to withdraw

from the marketing of Product 15, contrary to § 4(b)(1)(D). Thus the FEA's decision is inherently arbitrary because it is not consistent with FEA regulations, it is directly contrary to the policy objectives of the Emergency Petroleum Allocation Act of 1973 and it contravenes Congressional intent as expressed in EPAA.

Therefore, this Court concludes that General Crude is entitled to be treated as a refiner under 10 C.F.R. § 212.31 for the operations on the Banning Lease only. Accordingly, plaintiff's motion for summary judgment is granted.

Signed at Houston, Texas, this 10th day of March, 1978.

/s/ ROBERT O'CONOR, JR.
Robert O'Conor, Jr.
United States District Judge

APPENDIX III

IN THE
UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

CIVIL ACTION NO. 76-H-1108

GENERAL CRUDE OIL COMPANY

v.

FEDERAL ENERGY ADMINISTRATION
AND
THE UNITED STATES OF AMERICA

SUPPLEMENTAL MEMORANDUM

For purposes of clarification, the Court supplements its Memorandum entered in this cause on March 10, 1978 with the following:

(1) The Federal Energy Administration's finding that General Crude Oil Company is a "producer" of "crude oil" on the Banning Lease is not supported by substantial evidence; and

(2) The agency's Remedial Order to General Crude Oil Company is in excess of agency authority because it irreconcilably conflicts with agency regulations and Congressional and statutory directives, while failing to achieve any purpose entrusted to the agency.

Signed at Houston, Texas, this 12th day of May, 1978.

/s/ ROBERT O'CONOR, JR.
Robert O'Conor, Jr.
United States District Judge
(Filed May 12, 1978)

APPENDIX IV

FEDERAL ENERGY ADMINISTRATION

Washington, D.C. 20461

October 22, 1976

DECISION AND ORDER
OF THE FEDERAL ENERGY ADMINISTRATION

Appeal

Name of Petitioner: General Crude Oil Company

Date of Filing: July 1, 1976

Case Number: FEA-0855

On July 1, 1976 the General Crude Oil Company (General Crude) filed an Appeal from a Remedial Order which the Deputy Assistant Administrator for Compliance of the Federal Energy Administration issued to the firm on May 21, 1976. If the General Crude Appeal were granted, the Remedial Order would be rescinded on the basis of a finding that it was erroneous in fact and law.

Factual Background

General Crude owns one-half of the working interest in the Banning Lease which is located in West Newport Beach, Orange County, California. The firm acquired its share of the lease in 1966 and at the present time is the operator of the entire lease. An enhanced recovery method known as "in situ" combustion (fire flooding) has been in operation on the lease since 1958. Prior to December 1973, General Crude sold its share of the

production from the Banning Lease to the Standard Oil Company of California (Socal). Although the contract between General Crude and Socal did not specify the use to which the product was to be put, Socal used it as refinery feedstock. On November 17, 1973, pursuant to the regulations of the Cost of Living Council, General Crude certified to Socal that the product which it supplied was crude oil produced and sold from the Banning Lease. General Crude subsequently determined that its operations on the lease could not be sustained in the absence of additional revenues and the firm cancelled its contract with Socal effective December 1, 1973. General Crude then proceeded to solicit bids for its Banning Lease production, and on October 28, 1973, the Armour Oil Company (Armour) expressed an interest in purchasing the product for sale as heavy fuel oil. General Crude thereupon entered into a contract with Armour in which it agreed to sell Armour the total production from its share of the Banning Lease effective December 1, 1973. The billing statements which General Crude submitted to Armour indicated that the product produced and sold from the Banning Lease was fuel oil and the product was priced as if it were subject to the price regulations applicable to refiners rather than those applicable to producers of crude oil.

In the Remedial Order which he issued, the Deputy Assistant Administrator found that since December 1, 1973, General Crude has been selling the crude oil which it produced from the Banning Lease to Armour at prices which are in excess of the price levels specified in 6 CFR 150.354 and 10 CFR 212.73 and 212.74. The FEA specifically concluded that General Crude has been improperly determining its sale price for the crude

oil which it produces from the Banning Lease by reference to the provisions of the FEA Price Regulations which apply to refiners rather than those applicable to producers of crude oil. The Remedial Order also finds that the firm improperly characterized the crude oil which it sold as "residual fuel oil" in order to obtain a higher price than it would have received from the sale of "crude oil." On the basis of these findings the Remedial Order directed General Crude to:

(i) immediately reduce prices charged to Armour for lower- and upper-tier crude oil to lawful prices determined pursuant to 10 CFR 212.73 and 212.74;

(ii) refund to Armour the sum of $1,076,465.76 which reflects overcharges during the period December 1, 1973 through June 30, 1975;

(iii) recalculate the ceiling price for sales to Armour of "old" crude oil for the period July 1, 1975 through January 31, 1976 and refund all overcharges made to Armour during this period;

(iv) recalulate the ceiling price for sales to Armour of lower- and upper-tier crude oil for the period February 1, 1976 to the date of General Crude's receipt of the Remedial Order and refund all overcharges made to Armour during this period.

The Remedial Order further requires that General Crude refund to Armour all overcharges specified above, plus interest, within 60 days of General Crude's receipt of the May 21, 1976 Order.

On June 10, 1976 General Crude filed an Application for Stay of the Remedial Order pending the issuance of a final determination of an Appeal which General Crude indicated that it would file with the Office of Exceptions and Appeals. In an Order dated June 25, 1976 General Crude was granted a stay of those provisions of the Order which directed the firm to make refunds for past overcharges, on the condition that General Crude place the disputed funds in an escrow account established for that purpose. The FEA declined however to stay the provisions of the Remedial Order which directed General Crude to immediately reduce the prices which it charges Armour for crude oil produced from the Banning Lease to lawful levels determined pursuant to 10 CFR 212.73 and 212.74. *General Crude Oil Co.*, 3 FEA Par. 85,044 (June 25, 1976), *modified*, 3 FEA Par. 85,044 (July 8, 1976).

On June 29, 1976 General Crude requested that the FEA reconsider its prior determination and issue a Supplemental Order staying any requirement that General Crude immediately reduce the prices of the product which it sells to Armour. The FEA determined that since residual fuel oil had been decontrolled effective June 1, 1976, in the absence of a stay General Crude might be unable to recover the revenues which it would otherwise have received if it eventually prevailed on the merits of its Appeal. In order to alleviate the possibility of this type of injury, the FEA granted General Crude's request for a further stay subject to the condition that the firm deposit the funds involved into the escrow account which the June 25 Order directed it to establish. *General Crude Oil Co., supra.*

General Crude's Appeal of the Remedial Order was filed on July 1, 1976, and on July 14, 1976, a conference was held in connection with the firm's submission. In its Appeal, General Crude contends that the Remedial Order is based on errors of fact and law and should therefore be rescinded. General Crude's principal contention is that the FEA erroneously concluded that the firm's Banning Lease production is subject to the producer rather than the refiner price rules and that the findings of fact and legal basis contained in the Order are insufficient to support the determination which the FEA reached. General Crude further contends that: (i) the FEA erroneously concluded that the firm is liable for overcharges attributable to royalty owners' shares of production from the Banning Lease; (ii) the FEA erroneously found that the firm violated the provisions of Section 210.62(c); (iii) General Crude was denied due process in the proceeding which led to issuance of the Remedial Order; (iv) the FEA lacks authority to assess interest penalties; (v) the Remedial Order constitutes rulemaking and the FEA failed to comply with applicable statutory requirements; and (vi) the Order is arbitrary, capricious and an abuse of discretion.

Nature of General Crude's Activities

General Crude primarily contends that its production from the Banning Lease is residual fuel oil whose maximum lawful price should be determined in accordance with the refiner price rules rather than those applicable to producers. We have considered all of the arguments raised by General Crude in support of this contention and have concluded that the May 21 Remedial Order correctly determined that the substance which General

Crude recovers and sells through its activities on the Banning Lease is crude oil and that the firm is therefore subject to the FEA price regulations applicable to producers. It should be noted at the outset that the FEA already addressed the nature of activities at the Banning Lease in a prior proceeding involving another firm. On July 12, 1975, the FEA issued an Interpretation to G. E. Kadane and Sons (Kadane), the owner of the remaining one-half of the working interest in the Banning Lease. In the Interpretation the General Counsel of the FEA discussed the nature of Kadane's operation, the historical treatment of the product involved in the proceeding and the regulatory framework which must be applied in determining maximum price levels. The General Counsel concluded that although the substance recovered might arguably satisfy the technical specifications of residual fuel oil as well as crude oil, the operation of the lease was properly characterized as a production activity yielding crude oil. On Appeal Kadane argued that since the recovery process changed the composition of the product in the reservoir it could no longer qualify as "crude oil" and the nature of the product itself rather than factors such as its historical treatment and the characteristics of the firm involved should govern its classification under the Price Regulations. Kadane's position was not accepted and in a detailed Decision the Office of Exceptions and Appeals concluded that the substance involved did in fact fall within the definition of crude oil and that the factors upon which the General Counsel based his determination were correct. The Interpretation was therefore affirmed. *G. E. Kadane & Sons,* 3 FEA Par. 80,516 (December 5, 1976).

General Crude asserts that the *Kadane* case does not constitute a binding precedent with respect to whether

General Crude should be classified as a producer or a refiner. According to the firm's submission, General Crude and Kadane should be treated differently under the Price Regulations because General Crude alone terminated its contract for the sale of crude oil to Socal and began to market its share of the lease production as residual fuel oil. We find no merit in the argument which General Crude presents. It is clear that General Crude is the operator of the entire lease and the product which it produces and sells is identical in every respect to the product which Kadane sells. The fact that General Crude chose to begin referring to its product as "residual fuel oil" rather than "crude oil" at a later date in no way leads to the conclusion that it is in fact residual fuel oil as that term is used in the FEA regulatory program.

General Crude further asserts that the manner in which it treats the substance in question constitutes a refining process and that it therefore meets the definition of the term "refiner" contained in Section 212.31 of the FEA Price Regulations. According to General Crude, the tertiary recovery technique known as "in situ" combustion, which has been in use on the Banning Lease since 1958, involves the ignition and controlled burning under controlled pressure of a part of the heavy crude oil in the reservoir. General Crude states that this process "cracks" the hydrocarbons into larger fractions and, as a result, materially alters the chemical composition of the crude oil in the reservoir. General Crude further states that it concluded on the basis of laboratory studies which it conducted that the lease production could be marketed as heavy fuel oil if it first treated the material and blended it with non-cracked product. In November 1973 General Crude therefore installed treatment facilities at a cost

of $10,000. General Crude claims that after the substance involved is subjected to the various processes which the firm has instituted the product meets the specifications for residual fuel oil and that its activities therefore constitute the refining of residual fuel oil.

Assuming that the product may technically be considered as either crude oil or residual fuel oil, as the *Kadane* decision acknowledges, we are nevertheless persuaded that the Deputy Assistant Administrator properly determined that it was subject to the price regulations which are applicable to crude oil. The provisions of the Cost of Living Council Phase IV regulations, which were effective on August 15, 1973, and of the FEA Mandatory Petroleum and Price Regulations which superseded them, prescribe different pricing rules for producers of crude oil as compared with refiners. The maximum allowable prices applicable to the "first sale of domestic crude oil" were determined under the Phase IV regulations pursuant to 6 CFR 150.353 and 150.354 and are currently governed by 10 CFR, Part 212, Subpart D (Section 212.71 et seq.) of the FEA Price Regulations. "First sale" is defined as the first transfer for value by the producer or royalty owner. 6 CFR 150.54(s); 10 CFR 212.72. The term "producer" was defined at 6 CFR 150.352 as ". . . a firm which produces crude petroleum or any firm which owns crude petroleum when it is produced." This definition was incorporated into the FEA regulations. The maximum allowable prices which may be charged in the sale of covered products which are "purchased or refined by a refiner" were calculated under CLC regulations pursuant to 6 CFR 150.355, 150.356 and 150.357 and are currently governed by 10 CFR, Part 212, Subpart E (Section 212.83 *et seq.*)

of the FEA Price Regulations. Under both the CLC and the FEA regulations the term "refiner" is defined as:

> . . . a firm (other than a reseller or retailer) or that part of such a firm which refines covered products or blends and substantially changes covered products, or refines liquid hydrocarbons from oil and gas field gases, or recovers liquefied petroleum gases incident to petroleum refining and sells those products to resellers, reseller-retailers or ultimate consumers. 6 CFR 150.352; 10 CFR 212.31.

In the *G. E. Kadane and Sons* decision, *supra,* the FEA considered whether the substance recovered from the Banning Lease met the regulatory definition of "crude oil" [1] and concluded that it did. In the present Appeal General Crude does not appear to dispute the FEA's finding that the substance in fact constitutes "crude oil." Since General Crude is engaged in the production of crude oil, the firm falls within the scope of the term "producer." General Crude argues however that the "in situ" recovery technique, along with the subsequent blending and treatment to which the lease production is subjected, constitutes a refining process yielding residual fuel oil and that General Crude is therefore a refiner for purposes of determining the price at which the substance may be sold. After considering the arguments which General Crude raises, we are not persuaded

1. The term "crude oil" is defined in Section 212.31 as:
. . . a mixture of hydrocarbons that existed in liquid phase in underground reservoirs and remains liquid at atmospheric pressure after passing through surface separating facilities. "Crude oil" includes condensate recovered in associated or nonassociated production by mechanical separators, whether located on the lease, at central field facilities, or at the inlet side of a gas processing plant.

that the firm should be considered a refiner, even assuming that the product sold could meet the technical specifications for residual fuel oil. General Crude is essentially engaged in the recovery of crude oil fom underground reservoirs. The "in situ" combustion technique used by the firm does not constitute a refining process but is merely the manner in which the firm extracts the substance concerned from the property. Although the chemical composition of the substance recovered is in fact altered somewhat as a result of the "in situ" combustion technique, that process is used for the principal purpose of extracting the substance from the underground reservoir. Consequently, the incidental alteration in the chemical composition which occurs does not mean that General Crude "refines" covered products and is therefore a refiner rather than a producer.

General Crude's subsequent blending of the lease production with non-cracked reservoir fluids and its treatment of the substance in the facility which General Crude installed in November 1973 also fail to provide a basis upon which General Crude may qualify as a refiner. As an initial matter it should be noted that these operations are rather rudimentary and certainly do not involve the complexity and sophistication which are usually associated with a refining process. Furthermore, they do not substantially alter the nature of the product after its emergence from the ground. The firm's treatment facility, for example, is apparently nothing more than a filter which removes a portion of the water content from the lease substance and the $10,000 which General Crude used to construct this facility hardly represents the level of investment normally associated with a new refinery project.

Furthermore, from the time of its acquisition of a working interest in the Banning Lease in 1966 until December 1, 1973 General Crude sold the product to Socal. Although its contract with Socal did not specify the use to be made of the product, Socal used it as a refinery feedstock. In November 1973, subsequent to the promulgation of the Phase IV regulations relating to petroleum products, General Crude certified to Socal that the material which it produced and sold from the lease was crude oil. In May 1973 General Crude notified Socal that it intended to cancel its contract effective December 1, 1973 and began to seek a purchaser to whom it could sell the Banning Lease production for use as "residual fuel oil." It therefore appears that the lease product was historically treated as crude oil and that General Crude only began to refer to it as residual fuel oil after the CLC regulatory program was promulgated.

The facts presented in this proceeding therefore clearly indicate that the essential operation in which General Crude is engaged at the Banning Lease is the extraction of crude oil from underground reservoirs. That activity has always been regarded as the production of crude oil. The incidental and relatively insubstantial filtration and blending processes to which General Crude subjects the substances recovered in no way alter the fact that the fundamental activity in which the firm is engaged is and has always been the production of crude oil from underground reservoirs. Consequently, although the product concerned arguably meets the technical chemical specifications of residual fuel oil as well as of crude oil, General Crude possesses the characteristics of a producer and historically treated the product obtained from the

lease as crude oil. Therefore, we have concluded that even apart from the *Kadane* precedent already discussed, the Remedial Order properly held that General Crude's activities should be classified as the production of crude oil.

Due Process Considerations

Aside from the substantive considerations involving the nature of the product which General Crude extracts, the firm also contends that the Remedial Order is defective because it is not based on sufficient evidence and does not contain adequate findings of fact and conclusions of law to support the result reached. After examining the record in the proceeding we find no merit in the assertions which General Crude advances. In the Remedial Order the FEA discussed the precedent established in *Kadane*, *supra*, and the historical treatment of the Banning Lease production, including the factual events which led General Crude to determine the price of the substance which it extracted from the Banning Lease as if it were residual fuel oil. The Deputy Assistant Administrator also analyzed various issues which General Crude raised in its submission. On the basis of the findings reached the FEA concluded that the product had historically been sold as crude oil, that it meets the specifications for and regulatory definition of crude oil, that General Crude itself falls within the regulatory definition of the term "producer," and that the CLC and FEA regulations applicable to producers are the most suitable regulatory framework for the product which it extracts. Since the Remedial Order describes each of the factual and regulatory factors which led to the conclusion reached, the Remedial Order does

contain sufficient findings of fact and conclusions of law to sustain the FEA's determination. The Remedial Order also adequately apprises General Crude of the conclusions upon which the FEA based its determination. See 10 CFR 205.192(a); *Koch Industries, Inc.*, 2 FEA Par. 80,580 (May 2, 1975); *Coastal States Gas Corp.*, 3 FEA Par. 80,637 (May 27, 1976).

Conduct of Purchaser

General Crude further asserts that during the period of the alleged violation (December 1973 through May 1976) it sold its entire share of the Banning Lease production to Armour and that Armour resold the product without alteration for use as fuel oil. General Crude contends that since Armour sells the product as fuel oil and Armour has never attempted to sell the product as crude oil, General Crude should be permitted to do so as well. Even assuming that this argument is relevant, comments received from Sunland Refining Corporation (Sunland), a purchaser from Armour, contradict the General Crude assertion. Sunland states that from January 1974, when it first began to receive Banning Lease oil, until December 1974, deliveries of the product were designated as "crude oil" on freight tickets prepared by Armour. Sunland has submitted sample freight tickets which support this assertion. Sunland has also furnished sample invoices from Armour in support of its assertion that from January through April 1974 the product was invoiced by Armour as crude oil but that subsequent to April 1974 the product was identified as "Product 15," or fuel oil. Sunland claims that it used the product predominantly, if not exclusively, as crude oil. Furthermore, even aside from the Sunland evidence

there is no merit to General Crude's assertion that it should be permitted to determine the price of the product under the FEA regulatory program as if it were fuel oil merely because Armour may have called it fuel oil when it resold it. Implicit in the General Crude argument is the erroneous assumption that the classification of a firm's operations under the FEA Mandatory Petroleum Price Regulations should be based on the end use of the product. That assumption is not correct. In determining whether a seller is a producer or a refiner, it is necessary to examine the nature of the firm itself and the activities in which it engages, not the use to which its product is eventually put by other subsequent purchasers. On the basis of the discussion above we are persuaded that General Crude's extraction activities possess the characteristics of a producer as that term is used in the FEA Price Regulations. The firm cannot become a refiner merely because subsequent purchasers may use the product it sells in a particular manner.

Royalty Owners

General Crude further contends that the FEA erred in concluding that it should be held liable for refunding overcharges related to sales of the royalty owners' share of production from the Banning Lease. We have considered General Crude's assertions and determined that the Remedial Order appropriately directed that all refunds be made by General Crude. During the period of the violation General Crude was solely responsible for determining the prices at which its one-half share of the Banning Lease product was sold and the firm is therefore the party responsible for the violation. Since General Crude acted as the agent of the royalty owners for pur-

poses of sales of the product, it was certainly reasonable for the Remedial Order to treat General Crude as agent for the refunds as well.

Section 210.62(c) Violation

In addition to finding that General Crude violated the pricing provisions specified in Part 212 of the FEA Regulations, the Remedial Order also concluded that General Crude violated Section 210.62 of the FEA Regulations as well. According to the Remedial Order:

> General Crude's redesignation of crude oil produced from the Banning Lease product as "residual fuel" in order to avoid the CLC and FEA regulatory limitations on the price permitted to be charged in the first sale of crude oil represents a "practice which constitutes a means to obtain a price higher than is permitted by the regulations" in violation of 6 CFR § 150.20 and 10 CFR § 210.62(c). *Remedial Order* at p. 21.

In concluding that General Crude violated Section 210.62(c) the Remedial Order appears to proceed on the theory that General Crude's action in changing the designation of the product which it was selling and the firm's further action in stating that it was selling residual fuel oil constitute the type of practice which is prescribed under Section 210.62(c). We do not agree with the conclusion reached.

According to Section 210.62(c):

> Any practice which constitutes a means to obtain a price higher than is permitted by the regulations in this chapter or to impose terms or conditions not customarily imposed upon the sale of an allocated product is a violation of these regulations. Such practices include, but are not limited to devices making use of inducements, commissions, kickbacks, retroactive increases, transportation arrangements, premiums, discounts, special privileges, tie-in agreements, trade understandings, falsification of records, substitution of inferior commodities or failure to provide the same services and equipment previously sold.

The principal element of Section 210.62(c) involves the term "practice" which is used in the first sentence of the provision. A firm violates Section 210.62(c) when it engages in a practice which results in its charging a price which is in excess of the price prescribed by the FEA price regulations or imposes terms or conditions on sales of allocated products which are not customarily imposed in order to obtain a higher price than the price prescribed in the price regulations. As the illustrative examples in Section 210.62(c) indicate, the type of practice to which the regulation is primarily directed is an activity in which a firm attempts to disguise a price increase which it is in reality charging for the sale of covered petroleum products by shifting the charge to another sale or arrangement which may not be regulated directly by the FEA. Section 210.62(c) is also designed to prevent any firm from using an artifice, trick or scheme to obtain a higher price than it would otherwise be permitted to obtain. The element of deceit is often involved in this type of situation.

The record in this proceeding does not contain substantial evidence to support the conclusion that General Crude used the type of trick, artifice or device to which Section 210.62(c) refers. General Crude did not for

example attempt to raise the price of a service associated with the sale of the product which it extracted in order to disguise a price increase for that product. The firm also never attempted to increase the price of another product which might not be subject to the FEA regulatory requirements as part of a scheme which was in reality designed to obtain a higher price for the particular product which was subject to the FEA Regulations. Moreover as we have stated above the element of deceit is often present in a Section 210.62(c) violation. The record in this proceeding also fails to contain substantial evidence that General Crude attempted to deceive either the purchaser or the FEA. The purchaser of the product knew that it was obtaining the very same product which it had bought in the past. Insofar as the FEA is concerned, G. E. Kadane and Sons who along with General Crude owns the working interest in the Banning Field filed a request for interpretation as early as December 5, 1974 in which it described at length the pricing procedure which it had adopted. The record also contains no evidence whatever that General Crude attempted to obtain additional revenues aside from the price which it expressly charged for the product it delivered through the type of devices specified in the second sentence of Section 210.62(c). In our view General Crude's action in redesignating the product which it sold as "residual fuel oil" rather than "crude oil" represents an attempt by the firm to place itself in the most advantageous possible posture under the FEA regulatory program. In doing so the firm acted on the basis of an erroneous interpretation, charged improper prices, and thereby violated Sections 212.73 and 212.74. In our view that action did not constitute a "practice" which violated Section 210.62(c).

Since the present record in this proceeding does not contain substantial evidence that General Crude violated Section 210.62(c), those portions of the Remedial Order which refer to the Section 210.62(c) violation will be rescinded.

Remedial Order Proceedings

General Crude also argues that the May 21 Remedial Order is invalid because the FEA Procedural Regulations pursuant to which it was issued do not provide for an adequate hearing prior to the issuance of a Remedial Order and therefore violate the firm's right to due process. The nature of the FEA's compliance and enforcement procedures was discussed in *Wall Street Journal*, 2 FEA Par. 80,558 (March 21, 1975):

> The FEA Regulations envision that the first step in an enforcement proceeding will be an investigation. See 10 CFR, Part 205, Subpart P. Various mechanisms, both formal and informal, are available to FEA auditors and investigators during this stage. For example, 10 CFR 205.200 explicitly provides that the FEA may "issue subpoenas . . . (and) . . . conduct investigative conferences and hearings in the course of any investigation . . ."
>
> . . . In addition to these procedures, the FEA auditors also engage in less formal discussions with the officials of firms under investigation and their legal and accounting representatives. These contacts frequently clear up misunderstandings and obviate the need for further enforcement proceedings. However, if the FEA determines at the conclusion of a significant stage of the investigation that there is "reason to believe that a violation has occurred, is continuing, or is about to ocur," an NOPV may be issued. 10 CFR 205.191.

> The NOPV serves the function of a formal statement in which a person is informed of the nature of the violations which he has allegedly committed and is informed of his opportunity to respond to the charges. Consistent with due process requirements, the charges as specified in the NOPV must be set forth with sufficient particularity so as to inform the recipient of the specific course of improper conduct in which he has allegedly engaged and provide him with sufficient information with respect to the allegations so that he may prepare a response to the charges. The FEA Regulations specify that the party upon whom the NOPV is served has ten days in which to file a reply with the FEA. 10 CFR 205.191(c). Upon reviewing the material submitted by the recipient of the NOPV and the file in the matter, the FEA may conclude that a violation has occurred, is continuing to occur, or is about to occur and may issue a remedial order.

See also Koch Industries, Inc., supra; Coastal States Gas Corp., supra. General Crude does not contend that the FEA failed to adhere to these procedural requirements in this matter, and the record in fact indicates that the firm took advantage of the opportunity afforded to it to participate in the proceeding. For example, after the NOPV had been issued on October 17, 1975, General Crude filed a written reply to the charges on November 6, 1976 and a conference was held on January 23, 1976 between a representative of General Crude and the FEA Office of Compliance. At that conference General Crude was afforded an opportunity to amplify on its written submission and discuss any further matters which were relevant to the proceeding. The views which it presented were then taken into account prior to the issuance of the Remedial Order. We find no evidence whatever that General Crude was deprived of a sufficient opportunity

to present its view with respect to the matter under investigation or to persuade the agency that its position should be adopted.

Interest Specified in Remedial Order

General Crude's contention that the FEA lacks authority to require a firm to pay interest on refunds which it is required to make to the marketplace must also be rejected. In *Koch Industries, Inc., supra,* the FEA fully considered and rejected a similar contention as follows:

> Koch argues that interest payments of that type are punitive in nature, are more properly the subject of private actions brought by the aggrieved firms and are beyond the authority of the FEA.
>
> These arguments are wholly without merit. Administrative agencies have considerable latitude in fashioning remedies within the scope of their statutory authority, especially when the enabling statute expressly authorizes the agency to require such action to be taken as will effectuate the purposes of the statute. *Atlantic Refining Co. v. Federal Trade Comm.,* 381 U.S. 357 (1965), *reh. den.* 382 U.S. 873. *Securities and Exchange Comm. v. Chenery Corp.,* 332 U.S. 194 (1947). The Emergency Petroleum Allocation Act of 1973 (the EPAA) expressly directs the FEA to establish and administer an allocation and pricing program which will, to the maximum extent practicable, result in the . . . equitable distribution of crude oil, residual fuel oil, and refined petroleum products at equitable prices among all regions and areas of the United States and sectors of the petroleum industry, including independent refiners, small refiners, nonbranded independent marketers, branded independent marketers, and among all users . . . (EPAA Section 4(b)(1)(F)).

The Congress also specified the means by which such a program would be administered and enforced. EPAA Section 5. In accordance with this Congressional directive, the FEA Procedural Regulations set forth the procedures by which remedial orders may be issued to enforce the FEA Mandatory Petroleum Price Regulations. 10 CFR, Part 205, Subpart O. Those Procedural Regulations specifically state that:

> [a] remedial order or a remedial order for immediate compliance may require the person to whom it is directed to roll back prices, to refund amounts paid to such person that are in excess of the amount permitted under Part 212, *or to take such other action as the FEA determines is necessary to eliminate or to compensate for the effects of a violation.* (Emphasis added).

Contrary to Koch's allegations, the requirement that the firm include interest payments in refunds to its customers as mandated by the Remedial Orders is not punitive in nature. Rather, the provision is intended to fully compensate parties for the excessive amounts which were paid to Koch as a result of that firm's violation of the CLC and the FEA Pricing Regulations and which would have been available to those parties if Koch had met its obligations under Federal law. The additional revenues which Koch obtained as a result of charging unlawfully high prices could have been used by the firm's customers for a variety of productive purposes; instead, Koch had use of those funds for its own purposes over a period of time and may have been able to use that money to generate additional revenues for itself. If Koch were required merely to refund the specific amounts which it received through its violations of the CLC and FEA

Price Regulations, its customers would not be compensated for their lack of access to funds which properly belonged to them and which they could have utilized in a productive manner. Moreover, while it is true that such parties might have a private cause of action against Koch as a result of those violations, the existence of this remedy in no way bars the FEA from initiating action under its existing regulatory authority which would alleviate the effect of Koch's illegal activities. 2 FEA at pp. 80,761-2.

It should also be noted that the inclusion of interest in the refund obligation set forth in the Remedial Order is expressly contemplated by Section 205.195(a) of the FEA regulations which states that a Remedial Order "may require a person to whom it is directed to . . . make refunds equal to the amount (plus interest) charged in excess of those amounts permitted under Part 212 . . ." As we recently stated in *Atlantic Richfield Co.*, 4 FEA Par. _____ (September 24, 1976), that provision is necessary to ensure compliance with FEA regulatory requirements since a firm could otherwise use for its own purposes the revenues which it improperly obtained from a customer without being required to repay the value of its use. The considerations which the FEA expressed in *Koch* and *Atlantic Richfield* apply to the present proceeding. Interest in this instance represents the value of a sum of money which a firm was able to use over a period of time. For the reasons discussed in those cases it is appropriate to require General Crude to make adequate restitution for its use of the funds which it received by virtue of its violation of the FEA Price Regulations.

Prior Precedents

General Crude further contends that the interpretation of the FEA regulatory requirements reflected in the Remedial Order, and in particular of the term "refiner," constitutes such a substantial departure from the agency's prior practice as to constitute rulemaking, and that the Order is therefore invalid because the FEA failed to follow the procedures applicable to a rulemaking proceeding. We find no merit in that contention. The FEA did not, as General Crude asserts, alter its definition of the term "refiner." It instead determined that the activities in which General Crude has been engaging properly fall within the definition of the term "producer" rather than "refiner." Moreover, in concluding that General Crude's activities must be considered to be the production and sale of crude oil, the FEA Deputy Assistant Administrator clearly applied the precedent established in the prior *Kadane* Decision. Under the circumstances General Crude cannot reasonably contend that the present determination constitutes a departure from FEA practice.

Finally, General Crude asserts that the Remedial Order conflicts with certain national energy policy objectives, including preservation of an economically sound and competitive petroleum industry, equitable distribution of petroleum products, promotion of economic efficiency, minimization of economic distortion and encouragement of domestic energy self-sufficiency. General Crude states that adverse economic consequences, including the abandonment of the expensive recovery technique in use on the Banning Lease, will result from the FEA's determination that General Crude is subject to the producer price rules. Even if General Crude's economic predictions were

accurate, they nevertheless do not furnish a basis for sustaining General Crude's assertion that the conclusions reached in the Remedial Order are erroneous. As we have already stated, the Deputy Assistant Administrator correctly concluded in the Remedial Order that the producer price rules apply in the present situation, and General Crude must comply with the Price Regulations as written. If, as the firm asserts, it will incur a hardship or inequity as a result of the proper application of the producer rules, then the appropriate remedy lies in an Application for Exception. In fact, on September 21, 1976 the FEA granted General Crude exception relief which permits it to sell a portion of the crude oil which it produces from the Banning Lease at upper tier prices. *General Crude Oil Co.*, 4 FEA Par. _____ (September 31, 1976).

Based on the foregoing considerations, the Federal Energy Administration has concluded that General Crude Oil Company has failed to establish that the Remedial Order issued to it on May 21, 1976 was erroneous in fact or law or in any way arbitrary or capricious.

IT IS THEREFORE ORDERED THAT:

(1) The Appeal filed by the General Crude Oil Company from the Remedial Order issued to it by the Federal Energy Administration on May 21, 1976 be and hereby is granted to the extent specified in Paragraph (2) of this Order.

(2) Those portions of the May 21, 1976 Remedial Order which refer to or conclude that General Crude violated Section 210.62(c) of the FEA Regulations be and hereby are rescinded.

(3) The Remedial Order as modified by the provisions of Paragraph (2) of this Order is hereby affirmed and the General Crude Appeal from the provisions of the Remedial Order as modified be and hereby is denied.

(4) The Stay of the Remedial Order which was approved in the Decisions and Orders which the Federal Energy Administration issued to General Crude on June 25, 1976 and July 8, 1976 shall expire on the twenty-first calendar day following the issuance of this Decision and Order. The Deputy Assistant Administrator for Compliance of the FEA or his designee shall forward a copy of this Decision and Order to the escrow agent who is administering the funds which General Crude has deposited in the escrow account established under the terms of the prior Orders which the FEA issued in this proceeding. The Deputy Assistant Administrator shall further issue a directive to the escrow agent instructing the agent to deliver all funds in the escrow account to the Armour Oil Company on the twenty-first day following the issuance of this Decision and Order.

(5) This is a final order of the Federal Energy Administration from which an aggrieved party may seek judicial review.

/s/ MELVIN GOLDSTEIN
Director
Office of Exceptions and Appeals
Date: Oct. 22, 1976

APPENDIX V

FEDERAL ENERGY ADMINISTRATION

Washington, D.C. 20461

May 21, 1976

REMEDIAL ORDER
TO
GENERAL CRUDE OIL COMPANY

General Crude Oil Company
Post Office Box 2252
Houston, Texas 77001

Attention: Mr. K. E. Montague, President

Gentlemen:

On October 17, 1975, the Federal Energy Administration (FEA) issued a Notice of Probable Violation (Notice) to the General Crude Oil Company (General Crude) pursuant to 10 C.F.R. § 205.191 alleging the sale of certain crude oil at prices in excess of the prices permitted by CLC and FEA regulations and the improper characterization of such crude oil in order to obtain a price higher than that allowed by these regulations. General Crude filed a written reply to the Notice on November 6, 1975 and a conference was held between a representative of General Crude and FEA personnel on January 23, 1976 to discuss the issues outstanding under the Notice.

Based upon the information available to FEA and after consideration of General Crude's written and oral responses to the Notice, the FEA finds that violations of 6 C.F.R. §§ 150.354 and 150.20 and 10 C.F.R.

§§ 212.73 and 210.62(c) have occurred, as further described herein.

NOW, THEREFORE, pursuant to 10 C.F.R. § 205.192 (a), FEA hereby issues this Remedial Order to General Crude.

I. REGULATORY BACKGROUND

The pricing rules applicable to the sale of domestic crude oil were originally promulgated on August 19, 1973 (38 F.R. 22538, August 22, 1973) by the Cost of Living Council ("CLC") pursuant to authority vested in it by the Economic Stabilization Act of 1970 as amended, 12 U.S.C. § 1904, note ("Stabilization Act"). On December 27, 1973, the Federal Energy Office ("FEO") adopted CLC's pricing rules for petroleum products as part of what is now the FEA Mandatory Price Regulations. In CLC Order No. 47 (December 26, 1973), the Chairman of the Cost of Living Council delegated authority to the Administrator of the FEO to, among other things, "make determinations and take action with respect to Phase II, Phase III and Phase IV compliance and enforcement cases" received after December 21, 1973. Thus, the FEA is authorized to investigate and deal with violations of CLC price regulations for petroleum products for that period of August 19, 1973 through December 27, 1973, as well as those violations of FEA regulations after December 27, 1973.

The pricing rules promulgated by the FEA on December 27, 1973 were reissued on January 14, 1974 (39 F.R. 1924, January 15, 1974) and, with certain amendments not relevant here, remained in effect until February 1, 1976 when the pricing rules applicable to the sale of domestic crude oil were changed to conform

to the requirements of the Energy Policy and Conservation Act (P.L. 94-163, December 22, 1975).

II. APPLICABLE REGULATIONS

A. *Applicable Price Regulations for Producers*

The prices for the first sale of domestic crude oil are determined under the CLC regulations pursuant to 6 C.F.R. §§ 150.353 and 150.354 and under FEA regulations pursuant to Subpart D of Part 212, Title 10, C.F.R. "First sale" is defined, pursuant to 6 C.F.R. § 150.54(s) and 10 C.F.R. § 212.72, as the first transfer for value by the producer or royalty owner.

Pursuant to 6 C.F.R. § 150.352 (subsequently incorporated into FEA price rules as 10 C.F.R. § 212.31 and amended in a manner not relevant here), a producer is defined as: ". . . a firm or that part of a firm which produces crude petroleum or any firm which owns crude petroleum when it is produced."

6 C.F.R. § 150.353 initially established the ceiling price which producers could lawfully charge for "old" crude oil as:

> the sum of (i) the highest posted prices at 6:00 a.m., local time, May 15, 1973, for that grade of crude petroleum at that field, or if there are no posted prices in that field, the related price for that grade of domestic crude petroleum which is most similar in kind and quality at the nearest field for which prices are posted; and (ii) a maximum of $.35 per barrel.

On December 19, 1973, 6 C.F.R. § 150.353 (subsequently incorporated into FEA price rules as 10 C.F.R. § 212.73) was amended to raise the amount

permitted to be added to the May 15, 1973 posted price from a maximum of $.35 to a maximum of $1.35.

Prior to February 1, 1976, sale of "new" and "released" crude oil, as defined, was permitted without regard to the ceiling price (6 C.F.R. § 150.354 and 10 C.F.R. § 212.74), while the sale of crude oil produced from a stripper well lease was exempt from price regulations (6 C.F.R. § 150.54(s) and 10 C.F.R. §§ 210.32 and 212.54).

On February 1, 1976 the price regulations for producers of domestic crude oil were amended to establish a two-tier pricing mechanism designed to result in a maximum weighted average first sale price ("composite price") in February 1976 of $7.66 per barrel for all domestic crude oil. Crude oil sold at the lower tier consists of "old" crude oil and pursuant to 10 C.F.R. § 212.73 is subject to a ceiling price of the highest posted price in the same or nearest field for that grade of crude oil on May 15, 1973, plus $1.35 per barrel. Crude oil sold at the upper tier consists of stripper well lease crude oil and "new" crude oil and, pursuant to 10 C.F.R. § 212.74, is subject to a ceiling price of the highest posted price applicable to September 1975 transactions in the same or nearest field for that grade of crude oil on September 30, 1975, less $1.32 per barrel, subject to adjustment in months subsequent to February 1976 in accordance with FEA's second stage rulemaking.

B. *Applicable regulations Prohibiting Certain Business Practices*

CLC and FEA regulations, among other things, prohibit practices designed to result in higher prices for

covered products than are permitted by those regulations. 10 C.F.R. § 210.62(c) provides:

> Any practice which constitutes a means to obtain a price higher than permitted by the regulations in this chapter or to impose terms or conditions not customarily imposed upon the sale of an allocated product is a violation of these regulations. Such practices include, but are not limited to, devices making use of inducements, commissions, kickbacks, retroactive increases, transportation arrangements, premiums, discounts, special privileges, tie-in agreements, trade understandings, falsification of records, substitution of inferior commodities, or failure to provide the same services and equipment previously sold. (Prior to January 15, 1974, 6 C.F.R. § 150.20.)

III. ANALYSIS

A. *Facts*

As a result of information derived by its audit and investigation of General Crude and information supplied by General Crude in response to the Notice issued to it, FEA finds that General Crude and G.E. Kadane and Sons (Kadane), each own half of the working interest in the Banning Lease, West Newport Beach, Orange County, California, where an enhanced tertiary recovery method known as "in situ" combustion (fire flooding) has been in operation since 1958. General Crude acquired its share of the working interest in 1966 and is at present the operator of the entire lease. This *in situ* recovery operation involves the ignition and controlled burning under controlled pressure of a part of the heavy crude oil in the reservoir.

As a secondary result of this means of increasing the amount of crude oil recovered from the reservoir, the process changes the chemical composition of the reservoir crude oil by "cracking" hydrocarbons into lighter fractions.

From 1966 to November 1973, General Crude sold all of its share of the product produced from the Banning Lease to Standard Oil of California (SOCAL). Though nothing in the contracts between General Crude and SOCAL specified the use to which the product was to be put, SOCAL used the product as refinery feedstock. On November 17, 1973, pursuant to CLC regulations, General Crude provided SOCAL with the certification required in the sale of crude oil, attesting that the crude oil had been produced and sold from the Banning Lease.

An expansion during 1972 of the *in situ* operation caused a net profit loss with respect to General Crude's operation at the Banning Lease. Therefore, on May 18, 1973, General Crude gave the required six months notice for contract cancellation to SOCAL in order to obtain a higher price for its crude oil from another source. Accordingly, on October 3, 1973, a bid solicitation letter was issued to nine companies. On October 28, 1973, a response was received from Armour Oil Company ("Armour") which expressed an interest in acquiring the product and trucking it out of the Banning Lease *for resale as heavy fuel oil.*

Consequently, on November 15, 1973 General Crude entered into a contract with Armour which called for the sale by General Crude of approximately 2,000 barrels per day at a price of $4.40 per barrel, and further

included a clause which permitted a price adjustment commensurate with any upward change in the arithmetical average of the posted price of 15° gravity Kern type crude oil as posted by (1) Standard Oil of California, (2) Union Oil of California, and (3) Mobil Oil Corporation.

Although from December 1 through December 18, 1973 General Crude's price to Armour was $4.40 per barrel, on December 19, 1973 (the date of CLC's $1.00 increase in the ceiling price of old oil) the price per barrel escalated to $5.40. The contract between General Crude and Armour was renewed on November 6, 1974 at a price per barrel of $5.40, a price which has remained constant to the time of the issuance of this Order.

General Crude's billing statements to Armour listed the product sold to Armour as fuel oil and the product was priced as if the sales were subject to the refiner price rules (6 C.F.R. §§ 150.355 and 150.356 of CLC regulations and Subpart E of Part 212 of FEA regulations), rather than the producer price rules (6 C.F.R. §§ 150.353 and 150.354 of CLC regulations and Subpart D of Part 212 of FEA regulations).

B. *General Crude's Submissions*

In response to the Notice, General Crude made a number of arguments, all of which have been considered by FEA in reaching the decision reflected by this Order.

(1) General Crude's operation at the Banning Lease is a refining process producing residual fuel oil and, therefore, under FEA regulations, General Crude must be considered a refiner which has charged prices to

Armour not in excess of those permitted by the refiner price rules;

(2) Assuming that the Banning Lease product must be priced pursuant to the producer rules, General Crude states that the existence of substantial quantities of new and released oil for which there is no price limitation would absorb any overcharge; that some 116,310 barrels of "new" and "released" oil were not accounted for in the NOPV's calculations; and that it is not liable for any possible refunds relating to sales of royalty owner's product; and

(3) General Crude's sales of the product derived from the Banning Lease to Armour as "residual fuel oil" does not represent a "practice which constitutes a means to obtain a price higher than is permitted by the regulations" in violation of 6 C.F.R. § 150.20 and 10 C.F.R. § 210.62(c) because the product has always been residual fuel oil properly priced pursuant to the refiner price rules and because General Crude simply followed IRS' advice in making a good faith determination to use the "refiner" and "new item" regulations.

C. *FEA's Analysis and Determination of the Issues*

(1) ***General Crude's operation at the Banning Lease constitutes production and sale of crude oil and is subject to CLC and FEA producer price regulations.***

While General Crude, since December 1, 1973, has sold the product produced from the Banning Lease to Armour as residual fuel oil and computed its selling price

pursuant to the refiner price rules, Kadane has continued to sell the identical product to SOCAL as crude oil, computing its selling price pursuant to the producer price rules. An Interpretation issued to Kadane, pursuant to 10 C.F.R. § 205.85, by FEA's Office of General Counsel and dated July 12, 1975 held that "the maximum permissible selling price for the oil [produced from the Banning Lease] is determined under Subpart D of the Mandatory Petroleum Price Regulations, 10 C.F.R., Part 212." FEA's Office of Exceptions and Appeals upheld this Interpretation on appeal and stated that since "the product in question meets the legal definition of more than one covered product under FEA regulations . . . it was both necessary and proper for the General Counsel to have considered factors such as the nature of Kadane's operation, the relative suitability of the existing regulations, and the historical treatment of the product in determining the most appropriate subpart under which to regulate the commodity Kadane produces." *G. E. Kadane & Sons,* 3 FEA ¶ 80,516 (December 5, 1975.)

Though the opinion in *G. E. Kadane & Sons* concluded that Kadane's sales of its share of the product produced from the Banning Lease (a product identical to that sold by General Crude) are governed by Subpart D of Part 212, it is appropriate in the context of this Order for FEA to analyze the issues by General Crude before concluding that these prior FEA decisions are controlling in General Crude's case as well as in that of Kadane.

General Crude's principal argument is that the refiner price rules govern because General Crude falls within

the 10 C.F.R. § 212.31 definition of "refiner" which states as follows:

> A refiner is a firm (other than a reseller or retailer) or that part of a firm which refines covered products or blends and substantially changes covered products or refines liquid hydrocarbon from oil and gas field gases, or recovered liquified petroleum gases incident to petroleum refining and sells those products to resellers, retailers, resellers-retailers or ultimate consumers.

General Crude argues that because of this rather broad definition of "refiner" in FEA's price regulations (bolstered by the fact that the refiner definition is broad enough to cover the owner of a natural gasoline plant), the *in situ* operation at the Banning Lease must be considered a refining process. General Crude asserts that due to the effect that the *in situ* process and subsequent blending process have on the Banning Lease crude oil stock, General Crude must be considered a "refiner," since the company is a "firm which refines covered products or blends and substantially changes covered products. . . ." General Crude concludes that it has always been a refiner and that its sales to Armour represented sales of a "new item" pursuant to 10 C.F.R. § 212.111 (b).

Application of the refiner price rules would be problematic, even if appropriate. Pursuant to 10 C.F.R. § 212.83(b)(1), the base price for sales of a product by a refiner must include "increased product costs incurred between the month of measurement and the month of May 1973 and measured pursuant to the provisions of § 212.83." Yet, the operation at the Banning Lease

hardly lends itself to any determination of such increased product costs, since there can be no increase in the cost of this crude oil as it exists in the Banning Lease reservoir.

On the other hand, as is pointed out in *G. E. Kadane & Sons,* the Banning Lease product meets the regulatory specification for crude oil, and General Crude does and always has fallen within the 10 C.F.R. § 212.31 definition of a producer as a firm "which produces crude oil . . ." and its sales to Armour represent first sales of domestic crude oil pursuant to 10 C.F.R. § 212.71.

In short, General Crude historically sold the Banning Lease product as crude oil; the product meets the regulatory specifications for crude oil; the firm meets the regulatory definition of a producer; and the CLC and FEA provisions for producers are the most suitable to govern the product at issue. Thus, the prices charged by General Crude to Armour are properly govered by the producer price rules.

(2) *General Crude's sales of barrels of "old" crude oil to Armour during the period December 1, 1973 to June 30, 1975 at prices in excess of those permitted by CLC and FEA regulations resulted in overcharges to Armour of*

General Crude argues that, even if the producer price rules found in Subpart D of Part 212 govern the sales of the Banning Lease product, the existence of substantial quantities of "new" and "released" crude oil for which there was no price limitation at the time of the sales to Armour is available would absorb any overcharge. Such an approach is invalid since it would constitute a retro-

active price increase not permitted by CLC and FEA regulations. (10 C.F.R. § 212.74).

General Crude further argues that, even if the firm must be held to the pricing regulations for producers, some 116,310 barrels of "new" and "released" oil were not accounted for in the FEA Notice of October 17, 1975. The Notice had alleged that 812,925.3 barrels of "old" oil had been improperly priced resulting in an apparent overcharge of $1,154,353.93. However, subsequent to the issuance of the Notice, further examination of General Crude's books by FEA confirmed that FEA's initial calculations, although recognizing sales of "new" and "released" crude oil produced and sold from the Banning Lease, had not included credit for such crude oil at the prevailing market price. FEA further determined that General Crude had erred in defining its September 1972 base production control level (BPCL). Thus, FEA concludes that General Crude's sales of old demostic oil at $4.40 (prior to December 19, 1973) and $5.40 (after December 19, 1973) per barrel exceded the ceiling price imposed by CLC and FEA regulations during the period December 1, 1973 to June 30, 1975. Giving credit to General Crude for sales of "new" and "released" oil that would have been permitted to be sold at the then prevailing market price for such crude oil, FEA has determined that General Crude's activities, as described above, resulted in an overcharge of $1,076,465.76 (see Attachment A).

General Crude also contends that even if the Banning Lease product must be priced pursuant to the producer price rules, General Crude is not liable for any possible refunds relating to sales of royalty owner's product. FEA

regulations permit the flexibility of directing the agency's compliance effort towards royalty owners. However, in the present situation, it is more appropriate to require the refunds from the firm which actually produced the crude oil, recognizing that as to that part of the refund relating to sales of the royalty owner's product, General Crude has acted and continues to act as the agency for the royalty owners and can adjust its future payments to its royalty owners in accordance with the refund required by this Order.

(3) *General Crude's redesignation of the Banning Lease product as "residual fuel" represents a "practice which constsitutes a means to obtain a price higher than is permitted by the regulations" in violation of 6 C.F.R. § 150.20 and 10 C.F.R. § 210.62(c).*

As pointed out above, the operation of the Banning Lease must be characterized as a production activity yielding crude oil, subject to the producer price rules, rather than as General Crude contends, a refining process yielding crude oil, subject to the refiner price rules. The Banning Lease product meets the regulatory specifications for crude oil and Kadane has continued to sell its share of the Banning Lease product as crude oil, priced pursuant to the producer rules. General Crude from 1966 to November 1973 sold this product to SOCAL as "crude petroleum" and pursuant to the aforementioned regulations, General Crude had certified to SOCAL in November 1973 that crude petroleum had been produced and sold from the Banning Lease. Yet, on November 15, 1973 General Crude contracted to sell to Armour the Banning Lease product, which it characterized as "residual fuel oil." Despite such a characterization, the

escalator clause in this contract was directly tied to the posted price of *crude oil* in certain designated oil fields.

In contrast to sales of residual fuel oil which were permitted at a base price calculated by reference to a refiner's May 15, 1973 price and its increased product costs, sales of "old" oil production were subject to the ceiling price limitation of 6 C.F.R. § 150.353. Since much of the Banning Lease production was "old" oil, FEA concludes that General Crude's decision to redesignate its product as residual fuel oil was an attempt to justify sales of the product at higher prices than General Crude has been previously obtaining for such product and without regard to the ceiling price limitations.

General Crude argues that in its use of the "new item" and "refiner" price regulations, it was simply following "the written determination and advice it received from IRS in a good faith effort to comply with the letter and spirit of the regulations." However, the two documents attached to General Crude Oil's reply to the Notice to support this contention fail to do so.

The first, a December 20, 1973 IRS written determination that General Crude, as a firm engaging in extracting natural gas liquids, is considered a "refiner" and therefore subject to the refiner price regulations, is relevant only as to General Crude's natural gas liquid prices. It has no relevance to the sale of crude oil.

The second, a letter from Mr. James Carroll, a General Crude attorney, to Mr. Darrell Chandler, an Officer of General Crude, reports on a conversation held with Mr. Gary Dossett of the Internal Revenue Service. This letter represents an internal company communication indicating only that one IRS agent may have verbally indicated

that the "new item" theory was tenable, without expressing an opinion as to whether or not it would be sustained by the Cost of Living Council. Even were it possible to consider such letter as some indication of "confirmation" of General Crude's position, Subparts A and B of Part 155 of the Cost of Living Council regulations, which describe the procedures to be used for requesting interpretations during the period of time at issue, do not include provision for oral interpretations.

Indeed, if the November 9, 1975 letter indicates anything, it is that, though General Crude had historically sold the product produced from the Banning Lease as crude oil, upon discovery that it also met the specifications of fuel oil, General Crude determined to recharacterize it as fuel oil in order to sell the product under the refiner rather than producer price rules.

IV. FINDINGS OF FACT

(1) General Crude and Kadane each own half of the working interest in the Banning Lease, West Newport Beach, Orange County, California, where an enhanced tertiary recovery method known as "in situ" combustion (fire flooding) has been in operation since 1958.

(2) From 1966 to November 1973, General Crude sold its share of the Banning Lease product to SOCAL, a refiner, as crude oil.

(3) On November 17, 1973, pursuant to CLC regulations, General Crude provided SOCAL with the certification required in the sale of crude oil, attesting that the crude oil had been produced and sold from the Banning Lease.

(4) On November 15, 1973 General Crude entered into a contract with Armour for sales of the Banning Lease product, which General Crude designated as residual oil, at a price of $4.40 per barrel. On December 19, 1973, pursuant to the contractual terms, the price per barrel escalated to $5.40, a price which has remained consistent to the time of the issuance of this Order.

(5) Kadane has continued to sell the identical product to SOCAL as crude oil priced pursuant to the producer price regulations.

V. CONCLUSIONS OF LAW

(1) The product produced from the Banning Lease meets the regulatory specifications for crude oil. Therefore, General Crude's production of such product qualifies General Crude as a "producer" as that term is defined in 10 C.F.R. § 212.31 and the first sale of this product is subject to the limitation imposed by 6 C.F.R. § 150.354 and subsequent to January 14, 1974, Subpart D of 10 C.F.R. Part 212.

(2) In sales to Armour, General Crude failed to calculate the amount of "old," "new" and "released" crude oil produced from the Banning lease, selling such product as residual fuel oil and without regard to the limitations imposed by CLC and FEA regulations on sales of crude oil.

(3) Proper calculation of "old," "new" and "released" oil produced and sold from the Banning lease to Armour discloses that "old" oil was sold to Armour during the period December 1, 1973 to June 30, 1975 at prices in excess of those permitted by CLC and FEA price regulations.

(4) General Crude's sales of "old" crude oil to Armour during the period December 1, 1973 to June 30, 1975 at prices in excess of those permitted by CLC and FEA regulations resulted in overcharges to Armour of $1,076,465.76 (See Attachment A).

(5) General Crude's sales of "old" crude oil to Armour during the period July 1, 1975 to January 31, 1976 were at prices in excess of those permitted by FEA regulations.

(6) General Crude's sales of lower-tier crude oil to Armour from February 1, 1976 to the time of issuance of this Order were at prices in excess of those permitted by FEA regulations.

(7) General Crude's redesignation of crude oil produced from the Banning Lease product as "residual fuel" in order to avoid the CLC and FEA regulatory limitations on the price permitted to be charged in the first sale of crude oil represents a "practice which constitutes a means to obtain a price higher than is permitted by the regulations" in violation of 6 C.F.R. § 150.20 and 10 C.F.R. § 210.62(c).

VI. ORDER

General Crude is hereby ordered to take the following remedial action:

(1) Reduce its prices charged to Armour for lower-tier and upper-tier crude oil produced from the Banning Lease to lawful prices, determined pursuant to 10 C.F.R. §§ 212.73 and 212.74.

(2) Make restitution by refund to Armour of $1,076,-465.76, which reflects revenues received by General

Crude for "old" crude oil produced from the Banning Lease in excess of those permitted by 6 C.F.R. § 150.354 and 10 C.F.R. § 212.73 during the period December 1, 1973 through June 30, 1975.

(3) Recalculate, pursuant to 10 C.F.R. § 212.73, the ceiling price for sales to Armour of "old" crude oil produced from the Banning Lease for the period July 1, 1975 through January 31, 1976 and make restitution by refund to Armour of an amount which represents revenues received by General Crude in excess of the ceiling price during this period.

(4) Recalculate, pursuant to 10 C.F.R. §§ 212.73 and 212.74, the ceiling prices for sales to Armour of lower-tier and upper-tier crude oil produced from the Banning Lease for the period February 1, 1976 to the date of receipt of this Order and make restitution by refund to Armour of an amount which reflects revenues received by General Crude in excess of the ceiling price during this period.

(5) Compute interest on the aforementioned refunds in accordance with the following rates: (a) for amounts representing overcharges outstanding prior to July 1, 1975, a rate of 6% per annum; (b) for amounts representing overcharges outstanding from July 1, 1975 to January 31, 1976, a rate of 9% per annum; (c) for amounts outstanding after February 1, 1976, a rate of 7% per annum. Make immediate restitution to Armour of this interest amount.

(6) The above refunds shall be accomplished within 60 days after receipt of this Order by General Crude by means of check or by credit entries on future billings at Armour's option.

(7) The above refunds shall be accompanied by a written explanatory statement to Armour identifying such refunds as an act undertaken by General Crude in compliance with this Order. Such statement shall also advise Armour that the refund is necessary because of General Crude's erroneous classification of itself as a refiner for purposes of FEA price regulations and that such refund constitutes a decrease in product costs for purposes of FEA regulations applicable to Armour.

(8) General Crude shall maintain separate records showing its compliance with items (1) through (6) of this Order. Such records, as a minimum, shall contain compliance actions taken, dollar amounts of such actions, dates of actions and other evidence of restitution.

(9) General Crude shall submit a full report to FEA when full compliance with this Order has been achieved. This report shall also contain a statement certifying that all items in this Order have been accomplished. This report shall be due within 90 days after receipt of this Order by General Crude and will be submitted to:

Mr. Lon Smith
Acting Director
Compliance Case Resolution
Federal Energy Administration
2000 M Street, N.W.
Room 5212
Washington, D.C. 20461
(Reference Case No. 408)

VII. PROCEDURE AND APPEAL

This Order shall become effective when the time limit for filing an appeal from this Order has expired. Pursuant to 10 C.F.R. § 205.108, a written appeal from this Order

may be filed within ten days of service hereof. If this Order was served by regular United States mail, Section 205.5(c) permits an additional three days within which to file an appeal. A conference or a hearing in the context of the appeal may be requested pursuant to Section 205.172(b). At such conference or hearing, a party may be accompanied or represented by counsel.

Notwithstanding the filing of an appeal, this Order shall become effective when the time for filing an appeal expires unless a Stay is granted pursuant to the provisions of Subpart I of 10 C.F.R., Part 205.

Correspondence relating to the implementation of this Order should be addressed to:

Mr. Lon Smith
Acting Director
Compliance Case Resolution
Federal Energy Administration
2000 M Street, N.W.
Room 5212
Washington, D.C. 20461

A written appeal and correspondence relating to such an appeal should be addressed to:

Mr. Melvin Goldstein
Director
Exceptions and Appeals
Federal Energy Administration
2000 M Street, N.W.
Room 8002
Washington, D.C. 20461

Failure to comply with this Order after it becomes effective shall constitute a separate violation for each

day that such non-compliance continues, in accordance with the penalties and sanctions provided in 10 C.F.R. § 205.202. In addition, penalties and sanctions, as described in that Section, also may be levied, for each day that the violation described in this Order has occurred. If FEA considers it appropriate or advisable to compromise any civil penalties FEA will so advise you pursuant to 10 C.F.R. § 205.202(c)(2).

Sincerely,

/s/ JAMES R. NEWMAN
James R. Newman
Deputy Assistant Administrator
for Compliance
Regulatory Programs

Attachment

APPENDIX VI

TEMPORARY EMERGENCY COURT OF APPEALS
OF THE UNITED STATES

No. 5-29

GENERAL CRUDE OIL COMPANY,
Plaintiff-Appellee,

v.

DEPARTMENT OF ENERGY,
Defendant-Appellant,

and

THE UNITED STATES OF AMERICA,
Counterclaimant-Appellant.

BEFORE THE HONORABLE JOE EWING ESTES, HONORABLE FRANK M. JOHNSON, JR., AND HONORABLE WALTER P. GEWIN, JUDGES.

Upon consideration of Appellee's petition for rehearing and for rehearing en banc,

IT IS ORDERED that said petition is DENIED. The mandate will be issued seven (7) days from the date of this order.

FOR THE COURT:

Ruth H. Jacobson
Clerk

by DONNA M. BOLD
Donna M. Bold
Chief Deputy Clerk

November 9, 1978

APPENDIX VII

PERTINENT STATUTORY PROVISIONS

Emergency Petroleum Allocation Act of 1973, as amended, 15 U.S.C. § 4(b)(1), § 12, 15 U.S.C. §§ 751, et seq. (1975 Supp.) provides in pertinent part as follows:

> (b)(1) The regulation under subsection (a), to the maximum extent practicable, shall provide for—
>
> (A) protection of public health (including the production of pharmaceuticals), safety and welfare including maintenance of residential heating, such as individual homes, apartments and similar occupied dwelling units), and the national defense;
>
> (B) maintenance of all public services (including facilities and services provided by municipally, cooperatively, or investor owned utilities or by any State or local government or authority, and including transportation facilities and services which serve the public at large);
>
> (C) maintenance of agricultural operations, including farming, ranching, dairy, and fishing activities, and services directly related thereto;
>
> (D) preservation of an economically sound and competitive petroleum industry; including the priority needs to restore and foster competition in the producing, refining, distribution, marketing, and petrochemical sectors of such industry, and to preserve the competitive viability of independent refiners, small refiners, nonbranded independent marketers, and branded independent marketers;
>
> (E) the allocation of suitable types, grades, and quality of crude oil to refineries in the United States to permit such refineries to operate at full capacity;

(F) equitable distribution of crude oil, residual fuel oil, and refined petroleum products at equitable prices among all regions and areas of the United States and sectors of the petroleum industry, including independent refiners, small refiners, nonbranded independent marketers, branded independent marketers, and among all users;

(G) allocation of residual fuel oil and refined petroleum products in such amounts and in such manner as may be necessary for the maintenance of, exploration for, and production or extraction of—

(i) fuels, and

(ii) minerals essential to the requirements of the United States, and for required transportation related thereto;

(H) economic efficiency; and

(I) minimization of economic distortion, inflexibility, and unnecessary interference with market mechanisms.

Energy Policy and Conservation Act § 455, 89 Stat. 950, 965 (1975), provides in pertinent part as follows:

Conversion to Standby Authorities

Sec. 455. The Emergency Petroleum Allocation Act of 1973, as amended by this Act, is further amended by adding at the end thereof the following new section:

"Conversion Mechanism to Standby Authorities

"Sec. 12. (a) The President may not amend the regulation under section 4(a) in any manner which—

"(1) exempts crude oil produced in the United States from any provision of such regulation required to be made a part of such regulation by section 8; or

"(2) results in making such regulation, as so amended, inconsistent with any limitation or other requirement specified in section 8.

"(b) Except as provided in subsection (a), the President may amend the regulation under section 4(a) if he determines that such amendment is consistent with the attainment, to the maximum extent practicable, of the objectives specified in section 4(b)(1) and that the regulation, as amended, provides for the attainment, to the maximum extent practicable, of such objectives.

"(c)(1) Any such amendment which, with respect to a class of persons or class of transactions (including transactions with respect to any market level), exempts crude oil, residual fuel oil, or any refined petroleum product or refined product category from the provisions of the regulation under section 4(a) as such provisions pertain to either (A) the allocation of amounts of any such oil or product, or (B) the specification of price or the manner for determining the price of any such oil or product, or both of the matters described in subparagraphs (A) and (B), may take effect only pursuant to the provisions of this subsection.

"(2) The President shall submit any amendment referred to in paragraph (1) to the Congress in accordance with the procedures specified in section 551 of the Energy Policy and Conservation Act. Any such amendment shall be accompanied by a specific statement of the President's rationale for such amendment and the matter described in subsection (d) of this section. Such an amendment—

"(A) may apply only to one oil or one refined product category;

"(B) may apply to the matters specified in either subparagraph (A) or (B) of paragraph (1) of this subsection, or both; and

"(C) may provide for scheduled or phased implemention.

"(3) As used in this section the term 'refined product category' means—

"(A) motor gasoline;

"(B) Number 2 oils (Number 2 heating oil and Number 2-D diesel fuel);

"(C) propane; or

"(D) all or any portion of other refined petroleum product as a class (including natural gas liquids and natural gas liquid products, other than propane).

"(4) Such an amendment shall not take effect if either House of Congress disapproves such amendment in accordance with the procedures specified in section 551 of the Energy Policy and Conservation Act.

"(d)(1) The President shall support any amendment described in subsection (b) which is transmitted to the Congress under subsection (c) of this section with a finding that such amendment is consistent with the attainment of the objectives specified in subsection 4(b)(1) and in the case of—

"(A) any exemption described in subsection (c)(1)(A), with a finding that such oil or refined product category is no longer in short supply and that exempting such oil or refined product category will not have an adverse impact on the supply of any other oil or refined product subject to this Act; and

"(B) any exemption described in subsection (c)(1)(B), with a finding that competition and market forces are adequate to protect consumers and that exempting such oil or refined product category will not result in inequitable prices for any class of users of such oil or product.

"(2) Any amendment which the President submits to the Congress under subsection (c) of this section shall be accompanied—

"(A) by a statement of the President's views as to the potential economic impacts (if any) of such amendment which, where practicable, shall include his views as to—

"(i) the State and regional impacts of such amendment (including effects on governmental units);

"(ii) the effects of such amendment on the availability of consumer goods and services; the gross national product; competition; small business; and the supply and availability of energy resources for use as fuel or as feedstock for industry; and

"(iii) the effects on employment and consumer prices; and

"(B) in the case of an exemption described in subsection (c)(1)(B) of this section, by an analysis of the effects of such amendment on the rate of unemployment for the United States, the Consumer Price Index for the United States, and the implicit price deflator for the gross national product.

"(e) In any judicial review of an amendment required by this section to be submitted to Congress in accordance with the procedures specified in sec-

tion 551 of the Energy Policy and Conservation Act, the reviewing court may not hold unlawful or set aside any such amendment on the ground that any findings made by the President were not adequate to meet the requirements of subsection (c), (d), or (g) of this section or subparagraph (A), (E), or (F), of section 706(2) of title 5, United States Code.

"(f) With respect to any oil or refined product category which is exempted pursuant to the provisions of this section, the President shall have authority at any time thereafter to prescribe a regulation or issue an order respecting either the allocation of amounts, or the specification of price or the manner for determining the price, of any such oil or refined product category upon a determination by him that such regulation or order is necessary to attain, and is consistent with, the objectives specified in section 4(b)(1). Any such oil or refined product category for which allocation or price requirements are reimposed under authority of this subsection may subsequently be exempted without regard to the provisions of subsection (c) of this section.

"(g) Notwithstanding the provisions of subsection (e) of section 4, the President may, if he determines that the exemption from payments for certain small refiners required by such subsection—

"(1) results in unfair economic or competitive advantage with respect to other small refiners; or

"(2) otherwise has the effect of seriously inpairing the President's ability to provide in the regulation under section 4(a) for the attainment of the objective specified in section 4(b)(1)(D) and for the attainment of those other objectives specified in section 4(b)(1);

submit, in accordance with the procedures specified in section 551 of the Energy Policy and Conservation Act, an amendment to modify the regulation under section 4(a) with respect to the provisions of such regulation as they relate to such exemption. Such amendment shall not take effect if disapproved by either House of Congress under the procedures specified in such section 551."